

## Understanding the small business market in Gauteng: Findings from the FinScope small business Gauteng pilot survey 2006

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## Introduction

Small businesses play a vital role in any economy: they provide employment and competition, a few innovate and grow into businesses of scale and sophistication and importantly in the South African context they help reduce an overconcentration of economic power.

However, the desirability of small business is juxtaposed with their vulnerability. The reach of many well-intentioned support interventions is perceived to be low. Government focus on small businesses and the Financial Sector Charter is putting government and the private sector under pressure to come up with effective ways to bring about accelerated development and growth within the small business sector.

For the government and the financial institutions to define and implement these strategies for the sector, adequate information is essential. Though there is plenty of research into small businesses, none provides a comprehensive demand side analysis of small business usage of formal and informal financial products. To fill this gap, FinMark Trust decided to pilot a study on small businesses in Gauteng – South Africa's richest province - working with the Gauteng Enterprise Propeller, which will be referred to as "FinScope Small Business", based on the successful FinScope™ model.

## About FinScope small business

FinScope Small Business is a comprehensive survey focusing on the small business demand side to establish, among other things, small businesses' financial services requirements, usage, risks, access levels and the challenges that these small businesses are facing. It also aims to benchmark and highlight opportunities for innovation in product and delivery.

In brief the FinScope small business survey objectives are:

- **Market sizing and benchmarking**, defining the small business universe and quantifying it. This objective can only be achieved through a sample size that is representative of the small business market in a particular area.
- **Market segmentation**, the development and enhancement of a segmentation model for the small business sector, the Business Sophistication Measure,

- **Market needs analysis**, understanding the diverse small businesses needs and challenges, particularly regarding access to financial services, financial services requirements, usage, risks and the challenges that the small businesses are facing. The aim is to benchmark and highlight opportunities for innovation in product and delivery.

The survey extends over a spectrum of areas of financial interest, including small businesses' attitudes towards financial institutions, type of financial products preferred, use of technology, as well as levels of literacy, business skills and entrepreneurship skills.

In Gauteng, survey content included:

- Business profile (legal status, size, employees, ownership, sectors, track record)
- Financial and business management practices
- Target market and clients
- Financing of operations
- Banking practices
- Use of financial services
- Use of non-financial services and professional support
- Legal and tax compliance
- Psychographics

While there is much research on small enterprises, much of this is based on very small sample or located in a specific sector; the value of the FinScope small business survey lies in the representativeness of the data. Factors adding complexity in a representative survey of this nature include the lack of an identifiable universe of small businesses. This necessitated the use a mixed household and enterprise survey methodology moving from the enumerator area to the household to the enterprise. A total of 2001 businesses in Gauteng were surveyed.

### **Key findings:**

- More than a million people or one in six adults run small businesses in Gauteng.
- Half of Gauteng's small businesses are youth owned;
- For 78% of respondents the income generated is the only source of income for the small business owner;

- Some 7% specifically add value to the products they sell on, women are more likely to add value than men;
- Only 27% had a plan for engaging with 2010 World Cup Soccer opportunities;
- Non-SA citizens account from some 88 000 of Gauteng's small businesses, although this number is likely to be higher;
- Trading accounts for two thirds of all small business activity;
- 69% of small business operate from home;
- 70% of all businesses in Gauteng do not create jobs;
- Half of small businesses make between R1 300 and R2 000 a month, a fifth make between R750 and R900. These small businesses serve a vital social function and help make the poor a little less poor, they do not provide much dynamism;
- Credit extension to these businesses is so low that it raises questions about whether banks will achieve their commitments under the Financial Sector Charter;
- 41% of small businesses in Gauteng are unbanked. While banks are servicing the upper sector of the small business market with a variety of products the lower end of the market is either not using financial products at all or making do with a simple savings account and an ATM card;
- Most do not keep financial records and are not legally compliant – this prevents them from scaling up and accessing wider markets and capital;
- A quarter of small businesses report crime and theft as a problem;
- Approximately 7 in 10 are not aware of any organizations that provide support, back-up advice or training to small business – usage of these services is less (8%). The Umsobomvu Youth Fund is the market leader in this slow race.

### **A new lens on the small business market: The Business Sophistication Measure**

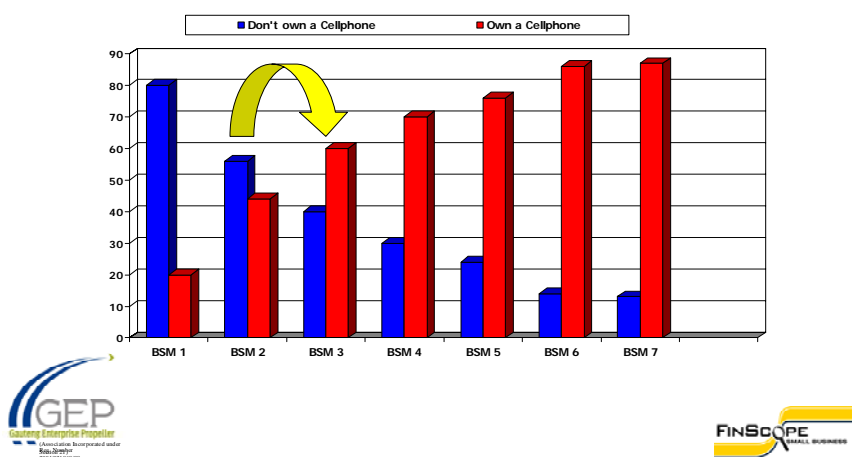
The small business market is so varied and diverse that it requires a classification tool that does not use a one-dimensional view of the formality, size or legal status of the business. Hence the Business Sophistication Measure was created as part of the Gauteng pilot, taking in variables such as where the business is conducted, whether a business keeps financial and other records, pays tax and issues of access to finance. The BSM identifies 7 segments, plotting the continuum of sophistication from informal street vendors to more sustainable business practices operating from a shop in an office complex, for example.

In Gauteng, BSM 1 are small vendors or hawkers, who have no access to water and electricity where they operate their businesses, which is mainly on footpaths or no fixed location. By contrast, in BSM 7, 94% of all small businesses are registered, have been operating for more than 10 years; most have a budget, a written business plan, keep financial records, use technology and can access a wide variety of financial products. A business budget and use of technology come to the fore in BSM 5 upwards. Insurance product use starts in BSM 6. In BSM 5 and 6, businesses move from sole trader status to employment-generating entities of greater sophistication. Importantly, this is also where entrepreneurs say they would rather run their business than work for somebody else in a job. BSM 7 steps

up significantly from other BSM tiers by creating on average nine jobs and having an annual turnover averaging R463 747.

Importantly this 'zone of transition' – moving from basic survivalist businesses to more formal entities – is a moving target: for personal banking it is in BSM 3 to 4, for business banking it is in BSM 4 to 5. Mobile phone use is however, a significant differentiator of businesses found as low as BSM 2.

## Zone of Transition Using BSM

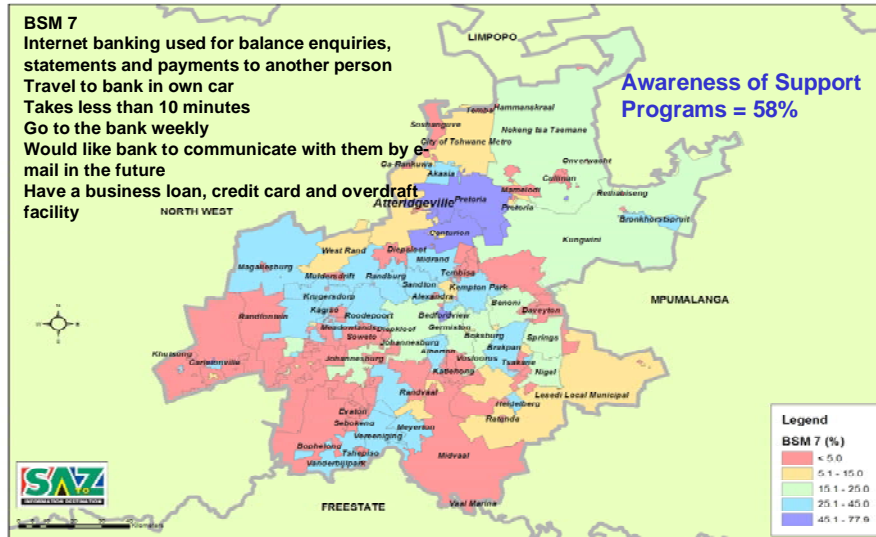


The BSM as a tool should allow government, the financial sector and other relevant actors to target their small business strategies to meet the needs of different segments, as well as identify opportunities for innovation in service and product provision to small businesses.

### Spatial mapping

BSM data was aggregated to municipal boundary level and spatially mapped – which has proven to be of value to key actors, for example, the Gauteng Enterprise Propeller.

# BSM 7



There is current discussion on rolling out the FinScope small business survey nationally which offers the opportunity to establish a common benchmark of market size, as well as enable provinces to link up their provincial findings to a national profile drawing on a standard sampling methodology. The BSM segmentation model combined with spatial mapping further allows for targeting and focusing of interventions to meet the needs of different market segments in specific locations.