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**Stimulating Rural Enterprise  
in South Africa:  
Lessons from Local  
Economic Development**

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## **1 Introduction**

This paper looks at options to stimulate entrepreneurship in rural areas in South Africa. It starts by asking whether the field of LED offers good practises which might simply be transferred to rural areas. The answer, as far as the current practise of LED in South Africa is concerned, is a clear No. LED in South Africa suffers from confused concepts and goals, and in its current form it is not very effective. There are, however, general principles for shaping LED in a way that would make it more effective, and these principles also apply to rural areas.

In the second section, the issue of entrepreneurship is addressed. Entrepreneurial dynamism in South Africa is low. There is a variety of factors to explain this, most notably bureaucratic obstacles and insufficient support structures. On top of that, there are mutually reinforcing factors such as crime, low visibility and absence of business organisations which raise the barriers to entry and to growth for businesses.

The conclusion is that enterprise promotion in rural areas must be based on a sound understanding of the market failures and mutually reinforcing systemic factors which impede business dynamism. Interventions must focus at reducing barriers to entry and making business opportunities more visible. They must address the root causes for weak entrepreneurship, not the symptoms.

## **2 What is Local Economic Development?**

Defining LED is no easy task. One way of trying it anyway is by saying what it is not:

- LED is not industrial policy, which is a traditional top-down, planning-driven approach to development policy. It is also not identical with SMME promotion, which should be a part but not the core of LED.
- LED is not regional planning. Planning can make an important contribution to LED. But while there is often economic development without anybody having planned for it, the process of planning does not secure that there is subsequent economic dynamism.

- LED is not community development. Community development is about solidarity – it is about self-help groups, mutual assistance and voluntary work to help the disadvantaged and solve health, education, housing and other problems. LED is about competitiveness – it is about companies thriving in competitive markets and locations thriving in a competitive, globalised world.

So what then is LED? Mostly, it is a process which involves a number of projects. Let us first try to describe LED by giving a few examples of typical LED projects:

- Different stakeholders from one sector, for instance tourism, come together to discuss, formulate and propagate a joint image promotion initiative for a location (e.g. municipality, district).
- Private business and council join forces to attract a foreign company which processes the products manufactured by a major local company.
- The council installs a task-force to streamline regulations and to design an office which assists businesses in understanding and complying with regulations (e.g. how to obtain a permit, how to fill out forms, etc.).
- The local Business Chamber organises a scheme where experienced businesspeople dedicate two hours per fortnight to coach emerging entrepreneurs.
- Council and business associations organise an annual fair for local products.

These examples lead us to a more analytical definition of LED: it is about local activities to make markets work better. It is not about distorting markets, and it is not about substituting them. LED aims at remedying market failures such as barriers to entry, information problems and high transaction costs. LED is based on projects like those mentioned before. LED is not about projects such as helping three ladies to raise chicken, or throwing a heap of money at a few people who want to open a funeral parlour (without any prior experience in the sector), or setting up hawker stalls. LED is about creating favourable framework conditions for business, not about running businesses. Running a business is the task of risk-accepting entrepreneurs. The core idea of LED is to make the risks involved in running a business calculable, and to make sure that the market for business ideas can work properly.

## 2.1 General Principles for LED

Taking a somewhat wider perspective, a way of defining LED is by formulating a few guiding principles:

- LED aims at making local markets work better. It aims at creating places and opportunities to match supply and demand, as well as to discover, propagate and promote new business opportunities.
- LED aims at creating favourable locational factors, i.e. qualities which make a given place a good place to do business. This includes obvious elements such as improving the infrastructure and training workers, but also less obvious elements such as the business-mindedness and efficiency of local administration.
- LED aims at promoting business. This can be existing businesses, start-ups or external companies coming into your location. You would also look at linking things: promote and support spin-offs and subcontracting, attract investors which fit nicely into the local economic structure, and consider franchises as a source of new local businesses. At the same time, LED must never create unfair competition for existing businesses, in particular by subsidising some companies to the detriment of others. It may often be justified to support start-ups, even financially, but this must be based on a clear understanding of barriers to entry (e.g. due to economies of scale) and other types of market failure, and it must be clear that this is a fixed-term support.
- LED aims at making better use of locally available resources. Instead of complaining about the difficulties of finding adequate advisors for the Local Business Service Centre, why not involve experienced business-people and managers in coaching both entrepreneurs and advisors?

It is important to note that LED involves very different target groups. A multinational company which may invest in your location is as much a target of LED activities as is the young black unemployed with limited skills who has some entrepreneurial talent. LED is about small and big things, and it includes everything from very modest to very fancy activities. What all this must have in common is business thinking. LED is not social work. The guiding principle of LED is competitiveness. You want to make sure that your location has qualities which are superior to those of other locations, so that companies choose your place rather than going elsewhere. And you want to make sure that local markets work, so that manifold business opportunities arise.

It is also important to note that LED is different from IDP. Whereas the IDP tends to focus at needs, problems and bottlenecks, LED ought to be driven by opportunities. IDP looks at long-term investment, whereas LED can keep itself quite busy for a while by looking only at short-term opportunities. IDP involves a long and intensive process of mobilising communities, whereas LED can be based on the activities of only a limited number of stakeholders. There is no need to form a consensus about the details of LED; it is sufficient that local stakeholders agree that there should be LED which is based of economics and business principles. An effort to form a consensus and to do a detailed planning of LED tends to get stuck in endless discussions with no practical activities being launched.

## 2.2 Options for South Africa

In the specific case of South Africa, it is notable that LED often is understood in a very different way from elsewhere in the world:

- It is often confused with territorial planning (in particular as Integrated Development Plans claimed to address, among other things, LED).
- It is often entangled with community development, which tends to lead to a situation where, due to conflicting rationales and goals, neither social nor economic objectives are actually achieved.
- LED is often focusing primarily on black empowerment and the promotion of emerging entrepreneurs.
- LED is often driven by “projects” which are not really projects, i.e. fixed-term, territorially limited activities, but rather quasi-businesses, which are not sustainable but rather driven by government grants, while creating unfair competition for existing businesses which have to survive without grants. As the grant is spent, the “project” usually collapses – and possibly has competed away established businesses in the meantime, so that in the end there has been destruction and frustration instead of economic development.
- LED is supposed not to be “smokestack chasing”. This is an adequate statement to the extent that luring external investors merely by offering subsidies is not a smart LED concept. However, it encourages a mindset which neglects the opportunities created through the attraction of external investors, thus forfeiting the option to attract the type of investor which have created millions of low-skilled jobs in Asia and Latin America.

In other words, LED in South Africa tends to be confused and highly selective. Adding to this the limited capacity and experience local governments tend to have in terms of promoting economic development, it is unlikely that LED, as it is currently being practised, will make much of a difference. What might be the principles of an adequate concept for LED in South Africa which does make a difference?

- Establish a clear distinction between LED and community development. LED is about creating functioning markets which encourage competitive businesses. Community development is about solving social problems (health, housing, education, neighbourhood), and it involves principles such as solidarity and support for the weak and marginalised. Do both things, but not at the same time, in the same project and with the same funds.
- Introduce a clear market and business focus in LED. Conceptualise black empowerment and the promotion of emerging entrepreneurs from this perspective. For instance, townships are full of business opportunities, but also full of market failures. Addressing market failure is the appropriate way to stimulate business opportunities, not subsidising potential entrepreneurs or entertaining them with shallow training courses. You don't solve a problem by throwing money at it.
- Realise the opportunities involved in the better utilisation of local resources. Why not use the business skills of experienced business persons to strengthen the capabilities of emerging entrepreneurs? Why not look systematically for local sourcing opportunities? Why not mobilise the locally available capital for local business investment?
- Instead of encouraging the creation of oversized, ineffective LED Fora, persuade local stakeholders to look for specific project ideas which are quickly implementable and make a difference for local businesses. The idea that innovation can be based on consensus is nonsense. With a huge LED Forum aiming at consensus, you get very boring, conventional ideas, and probably no practical results at all. Encourage local stakeholders to establish a governance structure only when there is something to be governed, i.e. when some practical projects are under way.
- Involve both the public and the private sector in LED. Don't leave LED to the private sector alone, since this may create too narrow a perspective. But also don't leave it to government alone, since government is usually not very good at understanding business matters. LED must be

based on a partnership between government and the private sector, and it should involve other stakeholders which are targeting economic issues.

To summarise this section, it must be pointed out that the conclusion cannot be “transfer the good practice from LED to rural areas”. Right now, there is little good practice in LED in South Africa. The predominant pattern of LED is unlikely to generate development, growth and income, and the last thing one would like to recommend is its extension into rural areas.

LED in South Africa is currently facing the challenge to fundamentally adjust its approach. LED which is based on sound economic and business principles might make a strong contribution to stimulating the creation of growth, jobs and income in the country. Such a different kind of approach to LED, which ought to be informed by experiences in other parts of the world, would most likely be applicable not only to cities and towns but also to rural areas.

### **3 Entrepreneurship development in South Africa**

Among the developing countries which are included in the Global Entrepreneurship Monitor (GEM), South Africa has the weakest performance when it comes to entrepreneurship and business start-ups. The number of entrepreneurs per 100 adults amounts to about a third of the number in Thailand, the leading country in the GEM index. The low degree of entrepreneurship applies both to opportunity- and to necessity-driven entrepreneurship, though the lag to other countries is much higher when it comes to opportunity-driven entrepreneurship.

The South Africa GEM country report connects the weak entrepreneurship performance to four factors (Foxcroft et al 2002, 6):

- the high transaction cost of tax compliance, in particular for young firms,
- weak support structures, in particular business development services which are not accessible or suffer from low quality,
- inadequate support structures for informal businesses,
- insufficient access to credit, in particular micro-finance.

These observations are supported by the evidence presented by Djankov et al (2000), which indicates that the cost of registering a formal business in South Africa is comparatively high. It amounts to 0.366 % of annual GDP per capita. In Canada, it is 0.014 %, in New Zealand 0.004 %, in Thailand 0.102 % and in Chile 0.116 %. In other words, government in South Africa is creating more obstacles to entrepreneurship than governments in other countries, while at the same time it is less effective in setting up support structures for entrepreneurship.

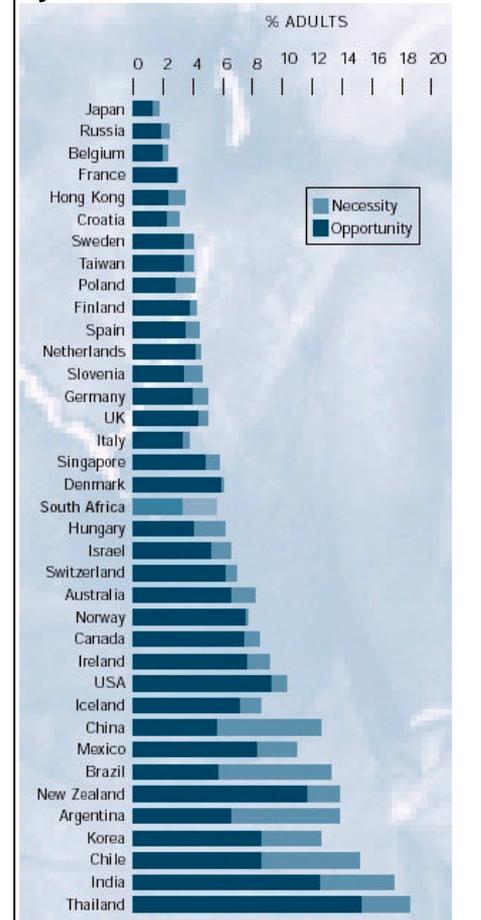
These problems are compounded by a confused concept of entrepreneurship and entrepreneurship promotion. While working with local communities since 2000, mostly in Mpumalanga, I observed four approaches to entrepreneurship. Three of them are obviously wrong:

1. Purchase a business plan, submit it for funding, obtain funding, spend funds for a BMW or a Bakkie, but have no product or customers.
2. Purchase a business plan, submit it for funding, obtain funding, use that money just like a wage, and the “business” collapses once the funds are used up.
3. Go through a skills course, use the skills to produce something, try to find customers for the product, but cannot find customers.
4. The only promising approach is the fourth one: Understand the behaviour and the problems of people, identify a market opportunity, match it with your skills, and then come up with a product or service for which there is real demand.

Unfortunately, this approach is much rarer than one would hope. In studies like the GEM, one of the main reasons identified for the limited incidence of this kind of approach is the lack of skills:

The long-term priority for increasing entrepreneurial activity remains the same as GEM 2001 – to improve access to and success in education. The biggest concern is the lack of core skills among entrepreneurs, ie financial literacy, record-keeping and marketing. There is an urgent need to intro-

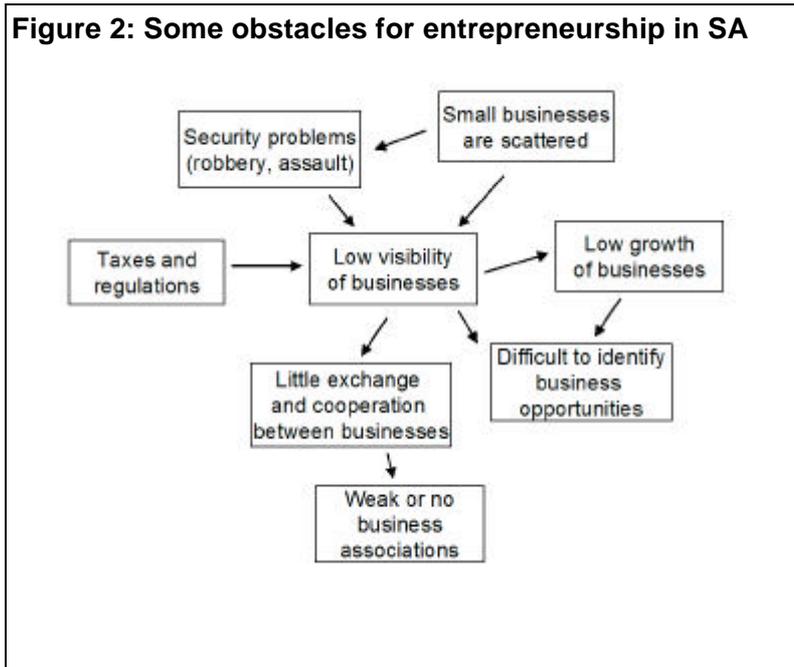
**Figure 1: Entrepreneurial dynamism in various countries**



duce financial literacy and basic business skills development in primary, secondary and tertiary education. (Foxcroft et al 2002, 6)

But I want to argue that we have to look beyond the skills issues to understand weak entrepreneurship. In my view, one of the main obstacles for entrepreneurial dynamism is a set of factors which reinforce each other. The pattern is visualised in Figure 2.

**Figure 2: Some obstacles for entrepreneurship in SA**



To explain this figure, let me start at the problem of low visibility of businesses. This is a huge problem because it generates a variety of other problems. It makes it difficult for local businesses to identify other businesses as potential suppliers or customers. It makes it difficult for potential entrepreneurs to identify business opportunities. It makes it difficult for business-people to meet other business-people, to share experiences, to learn jointly and to look jointly for solutions for shared problems. Subsequent effects include, among others, the lack of effective business associations.

Why are businesses little visible? To some extent it happens by default: They are scattered in townships or rural villages, hidden in private homes. But my observation is that beyond this, little visibility may also be the result of a deliberate decision. Owners of micro-businesses judge that the disadvantages, in particular the difficulties in advertising their offers to potential customers, are more than compensated by the advantages. One of the advantages of low visibility was already mentioned: a business stays unregistered and does not suffer from complicated tax rules, health regulations, building regulations, etc. The other advantage relates to security: the more visible a business is, the more likely it is to get robbed or assaulted, which given the crime rate in South Africa is a very important consideration. It leads micro-businesses not only to prefer low visibility, but also to opt for no growth, since more employees and more exposure increase the security risk.

## 4 Conclusions for entrepreneurship promotion

Based on these considerations, we can conclude that the policy recommendations advocated by the GEM – simplified tax rules, more effective support structures, better entrepreneurial skills – are necessary but not sufficient elements in stimulating entrepreneurship in SA. In fact, it may be the other way around: Simplifying taxes and regulations is not one of the things which are achieved overnight. And efforts to build up business support structures have been going on for years, most of them were not particularly effective, and again it is unlikely that the appropriate lessons are learnt and new approaches implemented overnight. Finally, regarding skills, the challenge is so enormous that it will take decades rather than years to remedy it. But at the same time we must acknowledge that countries like Thailand and Brazil, which rank very high in the GEM, are not exactly known for having world-class education systems. So while the GEM recommendations are valid, even assuming the best intentions of government it is unlikely that the environment for entrepreneurship will change quickly through changes from this side.

### 4.1 An example for a systemic approach to enterprise promotion

Where does this leave us? I would like to advocate the principles for a new approach to LED outlined above as a guiding post for entrepreneurship development, in particular in rural areas. The main point of this approach to LED is its business-focus: The purpose of LED is to stimulate business, and LED should be conducted in a business-like manner (as opposed to a bureaucratic or planning-driven manner). The starting point in designing an entrepreneurship promotion strategy must be the re-conceptualisation of problems as opportunities. A country like South Africa, and in particular rural areas there, seem to be full of problems and bottlenecks. However, many if not most of these problems and bottlenecks create business opportunities. Many of these opportunities are not realised for a variety of reasons, including the mutually reinforcing factors mentioned in Figure 2. If we are dealing with a systemic blockade constellation, it is obviously useless to start a discussion on which of the factors is the most relevant obstacle, and the one to be addressed first. Any promotion approach must rather address several factors at the same time. In practical terms, this may mean the following:

- One way of addressing the both the security and the visibility problem is the creation of small business estates. Admittedly, this is an approach which in many places has failed spectacularly in the past, and mostly for two reasons. First, there were too many subsidies involved. Second,

there was little or no communication with possible tenants at the planning stage, so that the layout and structure was not adequate to their needs. Avoiding these two errors substantially increases the probability of success. In fact, small business estates are a business opportunity for real estate developers. However, they may not go after this opportunity in townships or rural villages because they find that developments elsewhere offer a much more attractive ratio between benefit and cost and risk. This is a good example for a market failure which hinders entrepreneurial dynamism. How to remedy this market failure? One option is to do two things: First, throw in a matching grant to improve the risk/benefit ratio. Second, support the developer in her analytical effort to understand the opportunities and demands of a local community.

- One way of addressing the lack of communication problem is to create an opportunity for exactly this. A possible approach is to arrange business meetings, for instance at the local community hall. To create an incentive for business-people to appear, it may be useful to bring in speakers. However, two elements are crucial in getting beyond the first meeting. First, there must be opportunity for direct communication between business-people. It is useful, if not decisive, to have skilled facilitators to stimulate communication. Second, the participants must be involved in determining the issues to be addressed in the meeting, and the kind of topic to be presented by a speaker. A different issue refers to the political risk involved in this kind of activity: Local NAFCOG representatives may become very territorial when an initiative like this is started without their consent, and they as well as local politicians may try to hijack it. There is no blueprint on how to deal with this.
- One of the problems which reinforce the effects of low visibility is the lack of business directories. Commercial business directory providers often do not include township and rural businesses because of an unfavourable cost/benefit ratio. At the same time, having public agencies setting up business data bases or something like that is usually a recipe for disaster, since they lack the competence to manage it and the funds to update it. There is a clear business case for local entrepreneurs starting a little business directory business. This is a good example for explaining one of the principles of LED, namely making better use of local resources. There is no reason to offer major subsidies to this potential entrepreneur. It is rather recommendable to get him or her in touch with a mentor, i.e. somebody with some experience in and knowledge about business directories, and a sponsor, for instance a printing company (to lower the price of the first print run) or a bank.

## 4.2 The necessity to re-design support structures

How does all this relate to rural enterprises? My perspective is a very simple one: Rural enterprise, and the promotion of it, in principle is no different from enterprise elsewhere. Three factors distinguish rural enterprise from urban enterprise. First, the available purchasing power in the market that can be easily reached is lower than in urban areas. Second, the visibility of businesses is probably even lower than in urban areas. Third, the density of support structures – both non-profit and profit – is lower than in urban areas.

At the same time, this also means that there is a lot of untapped business opportunities in rural areas. Some of these business opportunities are of a different quality than opportunities which offer themselves in urban areas, in particular in terms of agricultural and extractive activities. From a layperson's perspective, it seems unlikely that the potential for agricultural and extractive products, such as unusual fruit and vegetables or aromatic oils, has been fully exploited, in particularly when comparing the variety of such products on sale in South Africa with what you can buy in countries like Brazil or Thailand. Where in South Africa is the corner shop that offers 40 different, freshly-prepared fruit juices that you can encounter all over Brazil?

In designing an entrepreneurship promotion strategy for rural areas, the first and foremost challenge is to clearly distinguish business development and social development. With the “project” approach to LED prevalent in South Africa, there tends to be a big confusion between economic and social objectives, and business and subsistence activities. One of the main problems is that promotion organisations are often not adequately organised. Simplifying things a little bit, we can organise the field as indicated in the following table.

	<b>Economic development Business promotion</b>	<b>Employment creation Poverty alleviation</b>
<b>Economic policy</b>	SMME promotion Entrepreneurship promotion Investment promotion	Basic and ongoing skills development Labour market information systems
<b>Social policy</b>	Support for subsistence-oriented micro- and small enterprise	Unemployment benefits Employment programmes

It is common to find that organisations in this area are organised along the columns:

- Business promotion agencies are supposed to deal both with competitive SMME and with survivalists.
- Employment promotion agencies are supposed to provide both training for highly skilled activities and for persons without any chance of integration into the labour market.

This creates all sorts of confusion, tensions and conflicts within these organisations. They are lost in endless and fruitless discussions of the competitiveness vs. subsistence and the picking the winners vs. supporting the losers varieties – as if those were alternative options given the current reality in the country.

The alternative approach would be to organise the activities along the horizontal lines, i.e.

- look for synergies between business promotion and skills development, and organise the execution of local economic development initiatives accordingly,
- connect the support for subsistence producers and employment-generation programmes, but make sure that this is not mistaken for business development.

### **4.3 Consequences for the promotion of rural enterprise**

Let us now look in particular at one point which pulls together the different lines of reasoning elaborated before: How to organise local economic development in rural areas? The first principle is that any intervention should be based on a sound analysis of market failure. The intervention should address the market failure directly, rather than the symptoms; the examples given above indicate what this means (e.g. address the security issue straight on instead of throwing money and unfocused training courses at potential entrepreneurs). To put it metaphorically: the idea is to lower the hurdles rather than issuing poles to potential entrepreneurs so that they can jump higher, only to realise later that pole vault is one of the most tricky exercises in field and track.

Lowering the hurdles means removing all sorts of obstacles to businesses, including those created by government. Despite its economic development rhetoric, government is frequently the most important obstacle for business,

as it requires all sorts of permits and licenses, causes protracted processes which keep business-people from their business, and sometimes employs persons who expect bribes from business-people.

But it is important not only to address obstacles to individual businesses, but also obstacles to value chains. Rural production, both agricultural and non-farm, tends to involve rather complex value chains, both in terms of inputs and commercialisation. If critical elements of a value chain are weak or non-existent, it will compromise the competitiveness of every business in the chain. Understanding value chains, analysing their bottlenecks and, together with businesses, defining measures to remedy the problems is an essential element of promoting rural entrepreneurship.

But which businesses and which value chains should you promote? Actually, I tend to argue that this is the wrong question. One of the problem of many academic papers is that their authors attempt to identify possible business opportunities, frequently find few, and thus conclude that there is little business potential. This conclusion, however, should not worry us because it is not based on business-driven thinking. It is crucial to understand that economic promotion at the local level has just nothing to do with traditional approaches of the industrial policy type, where government claimed to be “picking winners”. Business promotion activities must be based on the opposite principle: self-selection of businesses and potential entrepreneurs, irrespective of the market segment they want to serve. If entrepreneurs, as they often do, just copy what everybody else is doing, it is not the task of entrepreneurship promotion agencies to push them into other, possibly innovative activities. It is rather the responsibility of agencies to challenge entrepreneurs to think outside the box and to come up with innovative business ideas themselves.

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**mesopartner** is a consultancy partnership which specialises in local and regional economic development. It was founded in December 2002 and registered in April 2003 by Dr Ulrich Harmes-Liedtke, Dr Jörg Meyer-Stamer and Christian Schoen.

Currently, the main product of mesopartner is PACA. This is a methodology to kick-start or refocus local economic development initiatives which has been developed by Jörg Meyer-Stamer. It has been successfully applied in a number of developing and transformation countries. The main objectives of mesopartner are

- to further develop PACA, in particular in terms of specific formats for implementation and follow-up, which will feed into PM-LED (Participatory Management of Local Economic Development),
- to train PACA practitioners in various countries,
- to develop more specific PACA instruments, for instance for cluster analysis, value chain analysis and analysis of government-created obstacles to business.

Our next most important ambition is to further develop RALIS (Rapid Appraisal of Local Innovation Systems). As technology and innovation continue to be major preoccupations of local actors who want to create a localised advantage in a globalised world, we expect that there is a lot of potential demand for a tool like RALIS which addresses the most important obstacle for the leveraging of local innovation systems: fragmentation between local companies, agencies and organisations.

You find more information at our website, [www.mesopartner.com](http://www.mesopartner.com)