

THE ROLE OF SMALL MEDIUM ENTERPRISES IN THE IMPLEMENTATION OF LOCAL ECONOMIC DEVELOPMENT IN SOUTH AFRICA

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ABSTRACT

The notion of Local Economic Development (LED) in local government is pivotal and continues to generate debates among policy-makers, civil society groups and scholars throughout the globe. This is particularly because the local sphere of government is responsible for provision of basic services. LED in local government debate stems among other challenges of unemployment, infrastructure backlog and access to funding. Consequently, there is consensus among all these stakeholders that LED may have consequences for the socio-economic development programmes, particularly of developing countries including in rural provinces in South Africa. Small medium enterprises play a fundamental role in promoting LED. It is from this premise that this conceptual paper seeks to explore the role of small medium enterprises in LED. The paper further seeks to identify challenges associated with the contribution of small medium enterprises in economic development so as to recommend possible solutions to the identified challenges. It is concluded that amongst other challenges, the local sphere of government in the Limpopo Province lacks the necessary financial and human resource capacity to provide the said basic services and the requisite infrastructure.

Keywords: Local Economic Development, Small Medium Enterprises, Capacity, Infrastructure, Corruption.

1. INTRODUCTION

The notion of LED is closely related to poverty alleviation (Bartik, 2003:16; Ababio & Meyer, 2012:7) to an extent that the two concepts are

intertwined and in some cases, confused with each other. To this end, LED strategies usually form part of a comprehensive poverty alleviation plan particularly at local sphere of government so as to address the socio-economic needs of a specific community, within a defined geographical area. Since the democratic era in 1994, there has been much attention given to fostering LED with the purpose of promoting empowerment, job creation, economic growth and community development, with a primary focus on the role of small medium enterprises (SMEs) in local government sphere. According to the Africa Growth Institute (2010:38), SMEs development in local government typifies part of a LED strategy that aims to, among other priorities; achieve the local government's constitutional mandate to promote economic development in general. The Department of Cooperative Governance and Traditional Affairs (2009:45) advocates that the unique challenges confronted by weaker and more vulnerable municipalities in South Africa include but it's not limited to complex rural development problems and a massive infrastructure backlog legacy that requires extraordinary measures to address funding and delivery problems. As such, the Department posits that LED is significant but has been lacking consistency in practice due to poor infrastructure development and the skills required to shape and direct economic growth in local communities.

This paper is conceptual in nature and it seeks to explore the role of SMEs in LED. The reason being that, SME development in the South African local government typifies part of an LED strategy to address unemployment and poverty alleviation challenges. It therefore means there is an inevitable link between LED and SMEs. The paper further seeks to identify challenges associated with the

contribution of SMEs in economic development so as to recommend possible solutions to the identified challenges. It thus concludes that amongst other challenges, the local sphere of government in the Limpopo Province lacks the necessary financial and human resource capacity to provide the said basic services and the requisite infrastructure.

2. CONCEPTUALISATION OF LOCAL ECONOMIC DEVELOPMENT IN SOUTH AFRICA

According to Sibanda (2013:647), LED is a national government policy drive towards economic development that allows and encourages local people to work together to achieve sustainable growth and development. However, other scholars like Bartik (2003) and Sibisi (2009:5) refer to LED as a concept that has to do with the development of a territory, specifically aiming at stimulating the local economy to grow, compete and create jobs, by making better use of locally available resources. Meyer and Venter (2013) define LED as a participation in which local people from all sectors work together to stimulate local commercial activity, resulting in a resilient and sustainable economy. Moreover, it is also a way to assist create decent jobs and improve the quality of life for everyone, including the poor and marginalised, in doing so, LED encourages public, private and civil society sectors to establish partnerships and collaborate hence to find solutions to common economic challenges. Basically, LED seeks to build up the economic capacity of a specific locality so as to improve its economic future and the quality of life for all. Goga, Murphy and Swinburn (2006:27) are of the view that LED is a process by which public, business and non-governmental sector partners and work collectively to create better conditions for economic growth and employment generation. These stakeholders develop an LED strategy which is basically used as a guide in which local economy could be enhanced.

An LED strategy is an overall plan that has short, medium or long-term aims and actions and sets out what is going to be achieved. It basically establishes an agenda to promote and develop a local community's economic, physical, social and environmental strengths and will address both challenges and opportunities. SMEs worldwide are seen as the cornerstones of national economies in that in the South African context, they have the potential to reduce unemployment, generate income, create assets, contribute to skills development,

reduce the rate of crime and (often violent) service delivery protests, and attract investments in local municipalities (Malefane, 2013:671).

3. HISTORICAL EVOLUTION OF LOCAL ECONOMIC DEVELOPMENT POLICY IN SOUTH AFRICA

In South Africa, there are various policy frameworks which support and promote the notion of Local Economic Development. Section 152 of the *Constitution of the Republic of South Africa* of 1996 (hereafter referred to as 1996 Constitution) made LED an obligation for all local municipalities in the country, and in 1998 the White Paper on Local Government introduced the notion of developmental local government and LED as a key mandate. Patterson (2008: 18) argues that the basis for the current policy framework for LED was originally set down in the 1996 Constitution. Accordingly, Section 152 (c) and 153 (a) of the 1996 Constitution states that local government must "promote social and economic development" and it must "structure and manage its administration, and budgeting and planning processes to give priority to the basic needs of the community, and to promote the social and economic development of the community". The *Local Government: Municipal Systems Act, 2000* (Act 32 of 2000) legislated municipal LED functions as part of Integrated Development Planning to guide the process of a developmental local government (Rogerson, 2010:481; Munzhedzi, 2015:174). However, studies show that municipalities remained unclear on what LED means, how to organise it, and what to do in practical terms (Meyer-Stamer, 2002:16).

These policy frameworks are emphatic on strong state intervention, and that municipalities should play a leading role from the front, while LED is set of municipal projects to create jobs. The South African government created an LED fund to support poverty-reducing projects in 1999, housed under the national department responsible for local government (the former Department of Provincial and Local Government (DPLG), renamed the Department of Cooperative Governance and Traditional Affairs (CoGTA) in 2009). After a damning review of the Fund in 2003, the government reconsidered its approach to LED and in 2006 released new guidelines on LED" (Sibisi, 2009:32). Most significant in this regard is that the White Paper on Local Government of 1998 defined some of the challenges facing South African municipalities and provided the mandate to

local municipalities to deal with these challenges including but not limited to skewed settlement patterns, backlogs in service delivery and spatial segregation (Meyer & Venter, 2013). The LED may play a significant role in addressing some of these challenges. SMEs as one of the mechanism used to create jobs in the local economies are discussed in the paragraph below.

4. THE ROLE OF SMALL MEDIUM ENTERPRISES IN THE IMPLEMENTATION IN LOCAL GOVERNMENT

According to Oualalou (2012:57), SMEs play a very important economic and social role, both through their prominence in the economy and in job creation, a role which is greatly appreciated in these times of crisis and rising unemployment. Notwithstanding so, the development of SMEs can help to face many challenges linked with economic development in the country, inequalities, very high unemployment, demographic developments and the need for structural change. Furthermore, SMEs development offers many job opportunities which can help to lower the unemployment rate and address the demographic challenges posed by growing populations (Malefane, 2013). In addition, the development of the SMEs sector may assist in increasing competition and productivity and thus stimulate the growth of income both overall and per capita. This development will also stimulate structural change, since a healthy small medium enterprise sector is associated with innovation and technological upgrading.

Sibanda (2013:663) also concurs with the assertion that the SMEs sector plays a critical role in the South African economy by creating employment opportunities for communities within the second economy, as well as providing livelihoods to the dependents. In these regard, South Africa SMEs contribute approximately forty-five (45%) to the GDP (Sibanda, 2013). Malefane (2013) however posits that the support that the South African government provides for SMEs is widely acknowledged as the country's effort towards economic restructuring and poverty alleviation; conversely this acknowledgement results from governments' political and legislative commitment, through policy and strategy, to ensure that SME development is viable. SME development in the local sphere of government typifies part of a LED strategy that aims to, among other priorities; achieve the local government's constitutional mandate to promote economic development, in doing

so, the political support for SMEs has set the tone for legislation, policy and strategy direction and has resulted in the South Africa's legislation setting forth the national objectives for the SME economy (Geyer, 2006:2).

5. CHALLENGES OF LED IN LOCAL GOVERNMENT

The problems and challenges that SMEs are confronted with are multi-faceted and wide-ranging, furthermore among the factors that inhibit SME growth are inadequate business support services, quality or absence of business premises or infrastructure as well as Inadequate institutional economic delivery vehicles to support and enhance SMME in addition to a restrictive legal and regulatory environment (Adams and Madell, 2002:43). According to Kane, Madel and Pahwa (2006:16), the regulatory impact of municipalities on small enterprise is inextricably linked to their developmental and service delivery roles, notwithstanding, the ultimate impact of regulations is a function of a particular municipality's capacity to implement transformation. While uneven enforcement may be as a result of capacity constraints, municipalities may often choose to implement certain regulations selectively. According to the National Treasury (2011:207), most rural local municipalities such as Tzaneen, Ba-Phalaborwa and Molemolle Local Municipalities face a challenge in rising own revenue, particularly because the majority of the households are indigent. However, there are those households and local businesses that can afford to pay for services of which they contribute in economic development.

The Department of Cooperative Governance and Traditional Affairs (2009:51) posits that LED is of critical for the development of the country but has been erratic in practice due to the skills required to shape and direct economic growth in local spaces, as a result, South Africa has an advanced legal and policy context for LED, yet there is still challenges regarding implementation. In terms of the National LED Framework, municipalities have a very clear and defined facilitation role to play towards promoting economic development and job creation. The need for LED also arises out of the developmental challenge that economic development does not occur everywhere at the same time, but occurs unevenly and inequitably across economic space, landscape and social groups, creating major challenges in terms of satisfying the needs of the citizens with regard to employment opportunities, wealth creation and services particularly

for disadvantaged and marginalized groups (Meyer & Venter, 2013). LED strategies can therefore be framed as a process that responds to the development challenges that occur at local levels and bring together national, provincial and local government, business, community groups, international development partners to work in partnership (Wekwete, 2014:9). The partnership between the said stakeholders may positively contribute in addressing absolute and relative poverty, poor access to infrastructure and services, growing information of urban economies and decline and disappearance of existing industries. Some of the challenges of LED in South Africa include the following.

5.1 Corruption

Whilst corruption is a universal problem, it is particularly harmful in developing countries (Department of Public Service and Administration, 2003:11). Thornhill (2012) defines corruption as offering or granting, directly or indirectly to a public official or any other person, of any goods of monetary value, or other benefit, such as a gift, favour, promise or advantage for himself or herself or for any other person or entity, in exchange for any acts or omission in the performance of his/her public functions. Lerrick (2005:2) advocates that where there is poverty there is corruption. Munzhedzi (2016:1) is of the opinion that corruption refers to an abuse of official authority with intent for personal advantage. The most common types of corruption include bribery, fraud and the misappropriation of economic wealth. The reason for this may be associated with the fact that the provision of services in the developing societies is reliant on the government (Munzhedzi, 2016:1). It therefore means that the government and subsidy grants regarding LED initiatives may be received by undeserving small businesses and candidates. Businesses which do not qualify may pay bribes or kick-backs to receive the said grants and subsidies. According to Okafor (2004:98), corruption by political leaders has been identified as one of the major causes of poverty, and the failure in the development of developing countries, particularly in Africa, therefore the incidence of corruption remains one of the greatest challenges of democracy in the continent as virtually all democratic experiments are associated with reports of hyper-corrupt practices.

5.2 Poverty and Unemployment

According to Mavhungu (2011:35), poverty and unemployment are major factors that attributes to

the non-payment of municipal service fees in South Africa, as a result it also leads to the community engaging in municipal protests. South Africa is faced with a situation where the local sphere of government is put under ever-increasing pressure as poor people migrate from rural areas to urban in search of work, and to improve their living standards, in this regard poverty and unemployment does affect economic development. It is also worth noting that if people are not working, the business sector will not grow, and ultimately the market will be weak as no money will be injected into the economy to stimulate growth. Municipalities will not be able to aid LED innovations, through funding and skilling them, and as such a local economy will suffer.

5.3 Human Resources Capacity

There's often inadequate recruitment processes in the LED unit. Ingle (2014:479) is of the opinion that in far too many municipalities the post of LED Officer (where it exists at all) is seen as a virtual sinecure and is occupied by the most unsuitable candidates imaginable. Where senior officials in a municipality lack capacity, this deficit trickles down through the institution's organogram as ever less competent individuals are hired and competent ones move elsewhere in frustration (Munzhedzi, 2015:176). Appointment of unsuitable candidates may often lead to inadequate implementation of the LED programme. Lack of adequate organogram and suitably qualified personnel may also manifest in the lack of prioritisation of LED to such an extent that in some of the municipalities, the LED unit is staffed by one person (usually the LED officer).

5.4 Financial Resources

Another issue related to the question of human resources inadequacy is insufficient funding. The government's supportive role is often expressed through financial and non-financial mechanisms. Non-financial support includes but not limited to the control of inflation, reduction of tariffs and exchange controls, offering of tax incentives, investment in economic infrastructure and SME development through adequate policy framework (Malefane, 2013: 677). Some of the government institutions which contribute positively to LED are Industrial Development Corporation (IDC), Small Enterprise Development Agency (SEDA), and the newly established Department of Small Business Development. In addition to non-financial support, South African SMMEs have access to credit from

commercial banks (Turner, Varghese & Walker, 2002:22). However, Turner *et al* (2002: 22) cautions that credit granting tends to be in favour of SMMEs in the formal, rather than the informal sector, since informal sector SMMEs do not usually meet credit requirements. In certain cases, it was not necessarily the issue of a lack of prioritisation of LED that caused staff shortages, but a lack of funding for the programme. The generally poor attention paid to the LED unit may often contribute to low budget allocations. In recent years there have been sharp attacks on the desirability and efficacy of foreign aid for developing countries (Moyo, 2009; Polman, 2010). Other scholars also argue that it is far from clear whether donor finance always furthers the cause of LED. However, if properly used; donor funds may play a positive role in the promotion of LED.

6. THE CONTRIBUTION OF THE MUNICIPAL INFRASTRUCTURE GRANT (MIG) TOWARDS LOCAL ECONOMIC DEVELOPMENT

The fiscal decentralisation was conceptualised in South Africa about twenty years ago which was meant to transfer some powers to the third sphere of government, namely, the local government (Schoeman, 2006). Basically, when the fiscal decentralisation was introduced, the idea was that if the centres of decision making would be closer to the people, service delivery and poverty reduction would easily be addressed, therefore the structure of intergovernmental grant regime as well as the capacity of under resourced municipalities where the need for basic services is the highest. Municipal budgets and MIG are the main policy instruments that direct the expenditure stance of municipalities in achieving the infrastructure service delivery targets. To this end, inadequate municipalities infrastructure has negative consequences for the delivery of services and economic and development (Bikam, Chakwizira & Rapodile, 2015:10).

According to Smith and Da Lomba (2008:3), infrastructure plays an important role in the social and economic development of African countries, it is considered to be the hub of the economy which allow for the production of goods and services, without themselves being part of the production process. Infrastructure largely comprises road and rail transport system, public transport systems, airports, public educational facilities, water supply and water resources. Areas with poor backlog infrastructure are characterized by high rate of poverty with

municipalities tending to focus on the provision of access to basic municipal services and the provision and maintenance of general infrastructure and services within the municipal area.

The Department of Cooperative Governance and Traditional Affairs (2009) indicates that the MIG is the largest local government infrastructure development funding in South Africa, as a result the programme was introduced as part of major reforms implemented by government to improve service delivery as well as to strengthen local economic development in a coordinated manner that involves all government spheres.

7. THE FUNDING OF LOCAL ECONOMIC DEVELOPMENT

In terms of financing, a comprehensive approach is needed to enterprise development including a variety of stakeholders and access to micro-finance; stakeholders are generally regarded as parties who are affected or can affect actions and policies (Heideman, 2011:102). According to Atkinson and Ingle (2003), to access funds for LED, municipalities can either employ funds generated locally to implement municipal-led activities, such as through the levying of rates and taxes, or funding can be derived from higher spheres of government, however, LED has no secure funding sources and often relies on charitable donation and public funds. The role of local and international NGOs and donors is of great importance in accessing and making available funds for local development projects. The avenues for funding LED activities are summarized below.

7.1 Donor Funding

There are a number of donor agencies operating in the country including and not limited to the European Union LED support programme, USAID, and World Bank.

MIG

Supports basic infrastructure development and it is often financed from the higher spheres of government, namely, national and provincial government.

National Sector Support

There is a range of funding sources available from various government departments such as the Department of Water Affairs and Sanitation, and Department of Agriculture.

Development Finance Institutions

These institutions are inclusive of Independent Development Cooperation (IDC), Development Bank of Southern Africa (DBSA), National Empowerment Fund and National Development Agency (NDA).

Local Government Own Revenue

Municipalities to generate revenue from taxes and municipal services. High growth municipalities to support low growth municipalities.

7.2 Equitable Share

This is a share that comes from the provincial sphere and is distributed equitably across municipalities. This share seeks to improve utilization of provincial equitable share and transfers to municipalities. The foregoing is some of the sources often used to fund LED programme in the South African municipalities. According to Hindson (2007:33), there is a range of non-governmental support and international donor agencies that provide financial and technical assistance to municipalities and private sector groups such as the European Union, USAID, and World Bank. In doing so, the EU funds projects within the broad objectives of poverty alleviation and LED, including institutional capacity building. Hindson (2007:35) furthermore advocates that the European Union LED Support programmes in rural provinces such as Limpopo, Eastern Cape and KwaZulu Natal provide financial and technical support to local government as well as to the private sector through various application procedures.

The World Bank Group offers a limited number of grants to facilitate development projects to encourage innovation, co-operation between organizations and to increase the participation in projects of local stakeholders. Current projects in South Africa are enabled by a Technical Assistance Loan, implemented by the South Africa National Treasury with assistance of the DBSA (Heideman, 2011:37). Department of Trade and Industry (2008:33) posits that in terms of national support towards funding LED initiatives, a number of government departments and programmes provide support to municipalities and partnerships to engage in LED. In this regard, the MIG through the Department of Cooperative Governance and Traditional affairs (COGTA) provides support to municipalities to supply basic infrastructure development and improve service delivery. The aim of the grant is to provide all South Africans with a basic level of service, empower local municipalities, decentralise service delivery and

alleviate poverty. Municipalities applying to MIG for funding need to comply with a number of conditions in order to receive funding which includes an element of community participation to ensure the project meets the needs of local communities.

Section 229 of the 1996 *Constitution* assigns significant revenue powers to all municipalities in the country that, in addition to user charges, include rates on property and surcharges on fees for services provided by or on behalf of the municipality. Section 224 and 227 also guarantee that municipalities should receive an equitable share of nationally raised revenues, based on their assigned functions, fiscal capacity and developmental needs, among other matters. However, Section 227(2) relieves national government of any obligation to compensate municipalities that do not raise revenue commensurate with their fiscal capacity and tax base, and prevents it from penalising those municipalities who demonstrate fiscal effort. Government transfers alone may not successfully address all the service delivery pressures and backlogs that municipalities are confronted with. They are intended to supplement the municipalities' own revenues, with a particular focus on facilitating the provision of services to poor households and addressing rural infrastructure backlogs (National Treasury, 2011:205).

8. CONCLUSION AND RECOMMENDATIONS

Munzhedzi (2015:180) is of the opinion that despite South Africa's good legislative and policy frameworks regarding LED, evidence gathered through literature review suggests that the triple challenges facing the country, namely, unemployment, poverty and inequality still exists. Munzhedzi (2015) further posit that the LED programmes coordinated by municipalities have not made a remarkable dent on the said challenges. It is concluded that the public and private sector should have a stable relationship in fostering economic growth and community development by supporting Small Media Enterprises (SMEs) in order for the growth of market whereby jobs will be created as well as poverty to be alleviated. It is imperative for the government, in particular the National Treasury to supply good monitoring and evaluation on the LED program in order to have a clear assessment report as to whether economic development is taking place or not. Nevertheless, non-governmental organisations should also continue to play a pivotal role because they are instrumental in the stimulation of local economies. To address the corrupt element that may arise in the process of

LED implementation, measures should be placed on board in order to detect or deal with corrupt activities which seem to delay progress in local municipalities as well as to affect service delivery and economic growth. Some of the recommendations to address the continual challenges of LED in the South African municipalities are as follows:

- The process of addressing corruption in South Africa has been earmarked by a fragmented and uncoordinated approach. Some common anti-corruption agencies or bodies that exist are: Public Protector, South African Police Service (SAPS), National Prosecuting Authority (Asset forfeiture unit) and the Auditor-General (AG).
- According to Johnston (2001:1), good governance is a fundamental right of a citizen in a democracy and it is underpinned by factors such as transparency and accountability. Basically, good governance involves far more than the power of the state or strength of the political will. It therefore means that the facilitation, funding and the coordination process of the LED programmes and initiatives is transparent and cost-effective.
- Skills development interventions ought to be designed with focus on the current and future needs of the economy (Munzhedzi, 2015:180). Meyer and Venter (2013:99) correctly postulate that the focus should also be on critical skills in South Africa including but not limited to agriculture, mining, manufacturing and tourism so that they may be able to attract, maintain and expand local businesses.
- To address lack of funding as a challenge to effective LED policy implementation, government in its entirety ought to channel more funds to this cause (Munzhedzi, 2015:180). Often, municipality budget allocations for LED are quite minimal and thus inadequate in creating business and employment opportunities (Khumalo & Thakhathi, 2012:58).

In conclusion, the role of SMEs in local government is to stabilize the economy, particularly local communities with the aspect of empowering the youth and the previously disadvantaged people such as; women, disabled people and black people through the guidance of the Black Economic Empowerment (BEE). In doing so, the LED strategy aims to achieve the local government's constitutional mandate of

promoting economic development. The paper advocated that the Municipal Infrastructure Grant (MIG) is the largest local government infrastructure development funding in South Africa. Corruption remains the major cause of poverty and the failure of economic growth particularly in developing countries. To this end, LED through SMEs may positively play a significant role in enhancing the economic landscape of local municipalities in South Africa specifically rural municipalities. As indicated earlier, SMEs have the potential to reduce unemployment, generate income for the municipality, contribute to skills development in a particular locality, reduce the rate of crime and (often violent) service delivery protests, and also attract investments in local municipalities.

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