

Contemporary Second Economy and Business Contestations in South Africa

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Abstract: South Africa has countless entrepreneurs who engage in micro-enterprises that are ubiquitous in townships and rural areas. Accordingly, the current global landscape has given room to the proliferation of mushrooming informal businesses which are owned by competitive foreign nationals. A large majority of foreign nationals migrate to South Africa with capital, innovative ideas and skills to establish micro-enterprises; therefore, their businesses become more competitive than local traders. The informal economy in South Africa has given room for foreign entrepreneurs to establish and own factors of production including land. This paper posits that social capital, kinship and relations of reciprocity amongst competitive foreign national seems to be the common theme which sustains and more often than not proliferates informal businesses around poor third world township and rural areas in the second economy of South Africa. Unlike local informal traders who have been alienated from the mainstream production process through indoctrination of the "work for boss" mentality and unavailability of capital and skills; foreign traders seem to be spontaneously taking the upper hand. Thus, policy making efforts in the SMMEs sector have not offered a unique response in ensuring equitable distribution of productive opportunities amongst participants of the second economy, particularly indigent traders. South Africa's spatial inequality, social fragmentation and regimes that pay continued reverence to qualification accumulation over sustainable job creation are largely responsible for the current trajectory in the informal economic landscape. It is against this background that this paper contributes, that the paucity of social capital, entrepreneurial skills, financial literacy and economic resilience amidst destitute local traders creates an inexorable cycle of income poverty and dependency. It concludes that a strong point of departure would be investment in an entrepreneurial centred curriculum coupled with industry specific skills and resource development for local informal traders.

Keywords: Entrepreneurship, Informal Trading, Social Capital

1. Introduction

Informal economic activities are a source of survival at both urban and rural settings in South Africa; however, there remain stark inequalities between informal businesses that are owned by foreign nationals as compared to those of local traders (Butler, 2017). Seemingly, the mushrooming ownership and control of informal businesses by foreign national is indicative of the dearth of an entrepreneurship amidst the destitute majority of South Africans. Perhaps the legacy of the past injustices and alienation of the mainstream production process could justify the lack of business acumen (Charman, Petersen, Piper, Liedeman & Legg, 2017). Nonetheless, another lens is that the informal economy within which Small Medium and Micro Enterprises (SMMEs) operate is crippling in that it is characterized by a perfectly competitive market structure which does not provide a conducive environment for micro-enterprises to unfold. It is for these reasons that the informal economy innovates its own environment that is

conducive to enable smooth business operations. Thus, Social Capital, Kinship and relations of reciprocity remain the most important factors in sustaining the informal sector and its participants (Charman *et al.*, 2017). Notably, an increasing factor which helps most informal enterprises to succeed is social capital and relations of reciprocity amongst the traders (Mpembamoto, Nchito, Siame & Wragg, 2017; Crush, 2017). Thus the paper asserts that the informal economy in South Africa has been overlooked in policy making and planning in that there remain a huge inequality gap between local and foreign nationals in terms of business performance, market and financial opportunities amongst other. Some market participants have economic resilience over the other which allows them to recover from macro-economic shock, stressors, and challenges *inter alia*. Nonetheless, this article will include but be limited on the following aspects ; discussion on the contemporary second economy of South Africa, Informality and business challenges , perfect competition and SMMEs *inter alia*. In a nut shell, poor informal traders should

be supported and developed both financially and non-financially in order to stimulate the local informal economy (Mpembamoto *et al.*, 2017).

2. Contemporary Second Economy in South Africa

Many entrepreneurs at townships and rural areas engage in second economy for survival or as a livelihood to get access to wage while other entrepreneur's motives are to escape taxation (Butler, 2017). There is less competition in the current second economy as compared to the formal enterprises because they are unregulated and are flexible in changing of prices notwithstanding the problems which are caused by such informality. Current second economy does not pay any tax but they operate without being supervised legally by the government as compared to formal enterprises (Mpembamoto *et al.*, 2017). South Africa has countless entrepreneurs who engage in micro enterprises that are not registered and even employees are not protected by the law of which it is problematic because also their jobs are not protected (Cross, 2000). Second economy, other entrepreneurs are working in the formal economy also at the same time engage in the informal economy whereby they hire their relatives and become petty traders. In the second economy the profit is not sufficient as compared to the formal economy because of low start up and low prices of goods and services. There is unfair relationship between the informal and formal economy of which the state should address and ensure that they support the second economy (Mpembamoto *et al.*, 2017).

The second economy, continue to operate everywhere including rural and urban areas while many operate illegally. The registration of businesses from informal to formal the cost should be less and also the state should consider low rates of taxation. Many entrepreneurs do not register their businesses because of tax and labor laws; therefore, the government should be fair between large formal enterprises and to informal enterprises that are converted to formal enterprises (Van stell, Storey & Thurik, 2007).

3. Informality and Business Challenges in South Africa

Informal start-up enterprises together with micro, very small and small enterprises are seen to contribute between 27-34% of Gross Domestic

Product (GDP) and 72% of all jobs in South Africa (Department of Trade and Industry, 2008). Mostly, Africans more often than not dominate employment in the tiniest firms, with 42.5% of individuals engaged in micro-enterprises and informal start-ups (Sonobe *et al.*, 2011). Furthermore, a large number of informal-start-ups and micro-enterprises are concentrated within private households which are usually referred to as home based workers accounting 31.45% and the wholesale & retail trade 26.9% (Guylani, Talukda & Jack, 2009; Sonobe *et al.*, 2011). Additionally, approximately 75% of newly established small, medium and micro-enterprises do not succeed within the first two to three years of operation. Accordingly, South Africa has suffered a long history of economic deprivation which resulted in the entrepreneurial abilities of people mainly the impoverished to be dormant. Therefore, the high failure rate of such businesses in South Africa is to a large extent instigated by multiple challenges that impinge on their survival and growth prospects. These challenges include the perfectly competitive market structure which would result in the owners/managers of such enterprises to contemplate shutting down and continuing operation if the total cost of production exceeds the total revenue (Liedholm *et al.*, 2010). As a result, this could justify the number of business failures predominantly amid Africans who have been isolated from the mainstream production processes. Notwithstanding this high failure rate, approximately 24% of these enterprises in South Africa become established firms that could be regarded as panacea to the soaring unemployment problem (Liedholm *et al.*, 2010).

Gauteng Province being one of the most over populated domain in South Africa also acknowledges the importance of promoting micro-enterprises as a tool for income poverty reduction as stipulated in the strategic framework for small businesses (Daniels, 2006). Additionally, there are several types of retail establishment in Gauteng Province including but not limited to informal tuck shops, carpenters, traditional healers and shoe makers as well as a variety of vendors. According to the Department of Trade and Industry (DTI) (2005), informal businesses in South Africa play a key role through sustaining many livelihoods and offering a safety net for the income poor. It is therefore evident that the informal start-up enterprise in South Africa plays a pivotal role with regard to reducing the problem of achieving development. It is as well palpable that the nascent of informal start-up enterprises absorb

large proportion of unemployment labour force in South Africa, and this can further be applicable to other developing countries that are confronted with the issues such as unemployment, food insecurity *inter alia*. Although, the primary rationale and/or push factor behind the establishment of informal start-up enterprises apart from market opportunities is unemployment which is noticeable through income poverty (Daniels, 2006; Guylani *et al.*, 2009).

4. Perfect Competition and the Informal Sector

Perfect competition is an economic theory that occurs when none of the individual market participants (buyers or sellers) can influence the market price. For a perfect competition to exist there must be a large number of buyers and sellers of the product-the number must be so large that no individual buyer or seller can affect the market price (Van stell *et al.*, 2007; Mohr & Fourie, 2008; Liedholm *et al.*, 2010). Accordingly, informal start-up enterprises are omnipresent because of the ease of entry and exit in the market. As in the case of South Africa, a multiplicity of informal start-up enterprises exists including but not limited to; Hawking, street vending, Shoe repair, general dealing, restaurants, car wash, printing business and craft making *inter alia*. Each firm, for example, only supplies a fraction of the total market supply (Mohr & Fourie, 2008; Liedholm *et al.*, 2010). Most urban settings in South Africa are fronted by a plethora of informal start-up entities. Therefore, the first requirement for a perfectly competitive market structure should consist of a glut of buyers and sellers. Thus, this is evident in most urban central business district (CBD) (Piesse *et al.*, 2005).

There must be no collusion between sellers – each seller must act independently (Daniels, 2006; Mohr & Fourie, 2008; Guylani *et al.*, 2009). Given the unregistered nature of informal entities and a large number of firms selling homogenous products, it is less unlikely for the sellers to collude and fix prices because all the participants in the market have perfect knowledge about the going market price of the good or service at hand. As a price taker, a perfectly competitive firm is unable to charge a higher price above the market price and has no incentive to lower its prices suggesting that micro-enterprises are prone to make normal profits. Therefore, collusion amongst informal traders in an attempt to increase the prices of their goods

and services would be irrational because they exists an immediate substitute of the product that can be offered by any supplier in the same industry (Daniels, 2006, 2008; Guylani *et al.*, 2009).

All the goods sold in the market must be identical (i.e. the product must be homogenous). There should be no reason for buyers to prefer the product of one seller to the product of another (Liedholm *et al.*, 2010).

Buyers and sellers must be completely free to enter or leave the market – this condition is usually referred to as complete freedom of entry and exit. There must be no barriers to entry in the form of legal, financial, technological, physical, or other restrictions which inhibit the free movement of buyers and sellers (Liedholm *et al.*, 2010; Sewdass & Du Toit, 2014). As in the case of South Africa, informality bolsters the establishment of informal businesses. These embryonic business launches do not need any licensing or equivalent formal registration to begin operation. The primary Rationale for establishment of most informal start-up is poverty reduction. Nonetheless, in a perfectly competitive market, buyers and sellers are free to entry and exit the market because there are no stringent restrictions (Guylani *et al.*, 2009; Liedholm *et al.*, 2010).

All the buyers and sellers must have perfect knowledge of market conditions (Mohr & Fourie, 2008). For example, if one firm raises its prices above the market price, it is assumed that all the buyers will know that other firms are charging a lower price and will therefore not buy anything from the firm that is charging a higher price. However, this market situation has a potential to contribute negatively to the growth and sustainability of informal start-up enterprises operating in conditions of perfect competition because they are trapped in a vicious cycle of competition amongst similar firms in the industry. Accordingly, this evidently thwarting market structure gives rise to informality as there is no government intervention to fix the market price nor do the suppliers meet the necessary thresholds to benefit from government regulations and a variety of support from state enterprises and the private sector.

There must be no government intervention influencing buyers or sellers (Liedholm *et al.*, 2010; Mpembamoto *et al.*, 2017). Consequently, the lack of government intervention bolsters informality

within the informal start-up industry pigeonholed by *inter alia*; no registration, no compliance of state regulations and informal trifling trades.

Lastly, all the factors of production must be perfectly mobile. In other words, labour, capital and the other factors of production must be able to move freely from one market to the other. In a perfectly competitive market all the participants are therefore price takers—they have to accept the price as given and can only decide what quantities to supply or demand at that price (Guylani *et al.*, 2009; Mpembamoto *et al.*, 2017). Below is an indication of the requirements that should be met for a perfect competition to exist.

5. The Shut-Down Rule and Micro-Enterprises

The first rule is that a firm should produce only if total revenue is equal to or greater than, total variable cost (which includes normal profits) (Mohr & Fourie, 2008; Guylani *et al.*, 2009; Mpembamoto *et al.*, 2017). This condition is often called the shut-down (or close down) rule, but it can also be called the start-up rule because it does not just indicate when a firm should stop producing a product it also indicates when a firm should start (or restart) production. The shutdown rule can also be stated in terms of unit cost – a firm should only produce if average revenue (i.e. price) is equal to, or greater than, average variable cost (Guylani *et al.*, 2009; Mpembamoto *et al.*, 2017). In the long run all costs are variable. Production should therefore only take place in the long run if total revenue is sufficient enough to cover all costs of production.

Once a firm is established, it cannot escape its fixed costs. Fixed costs are incurred even if output is zero (i.e. if the firm does not produce at all). If the firm can earn total revenue greater than its total variable cost (or an average greater than its average variable costs), then the difference can help cover some of the unavoidable fixed costs of the firm (Liedholm *et al.*, 2010). It would be advisable for a firm to maintain production in the short run, even though it is operating at an economic loss. If total revenue is just sufficient to cover total variable costs (i.e. if average revenue is equal to average variable costs) it is immaterial whether or not the firm continues production – its loss will be the same in both cases (i.e. equal to its fixed costs) (Mohr & Fourie, 2008; Guylani *et al.*, 2009; Sewdass & Du Toit, 2014; Mpembamoto

et al., 2017). If total revenue is not sufficient to cover total variable cost (i.e. if average revenue is lower than average variable cost), the firm will not produce, because to do so will result in a loss greater than its fixed costs. In other words, the firm's losses will be minimized by not producing at all.

6. Way Forward on Contemporary Second Economy and Business Contestations

The government of South Africa should pay more attention to enterprises in the second economy, both rural and urban. Most rural areas are the ones affected by extreme poverty therefore support agencies and structures should pay concerted efforts on that (Lekhanya, 2010; Sewdass & Du Toit, 2014). There is an increasing migration of people from rural areas to urban areas looking for employment opportunities, thus, the government should not ignore the potential of enterprises in the second economy. Other enterprises in the second economy take years to grow and the government should intervene to ensure that they help and strengthen such enterprises. The foreign nationals' businesses are increasing and continue to increase in South Africa collapsing few of the enterprises owned by South Africans, the government needs to offer more assistance to them and elevate them to compete competitively in the economy (Lekhanya, 2010). It is not easy to manage an enterprise in the second economy because of nearby competitors that sell the same product for a lesser price. The government should allow micro-enterprises to register so that they can monitor their profits, check the ownership whether they are South Africans or foreign nationals in that way they will be able to monitor their progress. If a certain enterprise does not perform well they will be able to know and that will also enlighten the government in terms of the number of enterprises owned by South Africans and ensure equal distribution of resources. Most of entrepreneurs are not aware of the programs that are there to assist them. The government should be transparent in the distribution of information towards all people and business owners. The government should not only focus on the distribution of information but also supporting them with access to finance, mentorships and essential infrastructural facilities (Sewdass & Du Toit, 2014).

Strategic management and business creativity refers to the ability, capacity and intellectual

preparedness of business owners to lead, manage, organize and be proactive towards the multiple constraints and challenges that encroach on business success and longevity (Allen, Qian & Qian, 2005; Lekhanya, 2010; Sewdass & Du Toit, 2014). Amidst a plethora of informal start-up enterprises, street vendors and general dealers *inter alia* business creativity and strategic management education creates an opportunity for emergent informal entrepreneurs to surmount the market and create lucrative opportunities that will enable growth of success of the enterprises. Continuingly, strategic management education for informal start-up entrepreneurs does not refer to technical and sophisticated business and econometric models that will be difficult for destitute informal traders to fathom, it rather encompasses rudimentary strategic management aspects such as the strength weaknesses opportunities and threats model (SWOT), feasibility study, basic entrepreneurial skills, business plan writing, basic consumer behaviour, financial management and bookkeeping skills, human resources and people management skills (Beck, Lu & Yang, 2015).

Continuingly, the pragmatic implementation of the aforesaid strategic management aspect will give aspirant entrepreneurs an edge over existing ones that do not have any knowledge about managing and growing an informal entity (Beck *et al.*, 2015). However, it is important as an aspirant entrepreneur should be able to coordinate and unite all the factors of production including land, capital, labor and entrepreneurship to enable enterprise success. On the other hand, South Africa's experience in entrepreneurship has been bad, particularly amongst historically disadvantaged back people mainly because of the historical legacies of apartheid, colonization, deprivation and the "work for boss mentality" (Guylani *et al.*, 2009). Concisely, dealing with these issues requires inculcating the entrepreneurial and business mindset amidst street traders and owners of informal start-up entities (Beck *et al.*, 2015). Thus, a new development policy trajectory should be crafted in the ministry of SMMEs that stipulates that it is mandatory for all incipient informal traders who have been isolated from the mainstream formal economy to have access to cutting edge strategic management, business and entrepreneurial skills that is instrumental to their growth, longevity and possible graduation into the mainstream formal economy.

7. Conclusion and Recommendations

Turning a blind eye towards placing concerted efforts on supporting local informal traders in the second economy of both rural and urban areas will lead to an endless cycle of poverty and inequality amongst the traders. South African informal sector should move towards creating a conducive environment which will allow for work the unregulated informal economy to flourish. Policy making efforts in the SMMEs sector should be geared towards striking a balance between foreign nationals and local traders in as far as market opportunities are concerned. Foreign investment policy in the informal sector of South Africa should create an enabling environment for the development of informal businesses which are owned by foreign nationals in ways that support the businesses of local small scale workers. Production opportunities and platforms should not be provided to the advantaged few who are not indigenous people of South Africa on a silver platter; it should be created through in a way that allows for the development of and support of poor traders. Thus, the bigger point of departure would be moving towards being an entrepreneurial oriented nation which becomes producers of goods and services rather than consumers. Therefore, entrepreneurship with support from various stakeholders and actors in the economy is an important point of departure for South Africans informal economy.

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