



# Accelerating the Growth of SMEs in South Africa.

## THOUGHT LEADER PERSPECTIVES

The Top 25 constraints inhibiting the development of effectively functioning entrepreneurial ecosystems in South Africa

**SIMODISA**  
**START-UP**

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## SECTION 1

# Executive Summary

SiMODiSA's mission is to facilitate a quantum leap in South Africa's entrepreneurship landscape, best illustrated by the goals of seeing thriving and competitive Angel investment, Venture Capital, and incubation networks, resulting in more entrepreneurs growing further and faster and more jobs being created to build a prosperous nation. Part of our modus operandi is to tackle the most leveraged constraints in the ecosystem.

With generous support from the Omidyar Network Africa, First National Bank (FNB) and the South African Venture Capital and Private Equity Association (SAVCA), SiMODiSA and its research partner, the Impact Trust, organised five facilitated "thought leader dinners". These took place in Cape Town and Johannesburg in October and November 2014. Each dinner had a slightly different thematic focus, and engaged a diverse group of thought leaders, drawn from prominent entrepreneurs, angel investors, captains of industry with an entrepreneurial and innovation-driven reputation, venture capitalists, SME funders, policymakers and academics on the topic of entrepreneurship in South Africa. The purpose was to discuss and identify the top 25 constraints that hinder thriving entrepreneurial ecosystems in South Africa.

The insights shared by our guests have been carefully distilled and are reflected in this report as The Top 25 Constraints to Entrepreneurship in South Africa. They have been categorised and considered in terms of how they each align to the four defined archetypal models of entrepreneurship (namely the models of: high-tech entrepreneurship, local hero, mothership and external trigger) and those that are crosscutting in nature and affect all types of entrepreneurs<sup>1</sup>.

The articulation of these constraints represents a critical outcome that will enable SiMODiSA to collaborate with key government decision-makers and work towards the development of solutions to the multi-faceted challenges. Ultimately these issues set the research and Public Private Partnership agenda for SiMODiSA in 2015 and beyond.

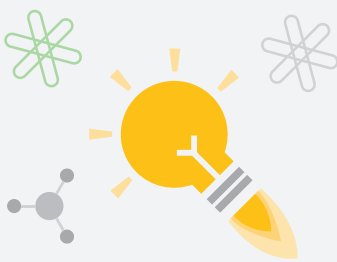
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<sup>1</sup> The archetypes were identified through the Monitor Group's experience in benchmarking surveys conducted in 22 countries and over 150 projects in regional development around the world. During the course of their work, Monitor identified the four generic models of how entrepreneurship develops and may flourish within specific environmental contexts.



# The Top 25 Constraints are:

## TOP ISSUES PER ARCHETYPE MODEL



### High Tech Entrepreneurship

1

Skills deficit

2

Funding needs (Angel Networks; incentives; endowment)

3

Remote location and limited access to markets

4

Current government procurement limitations (PFMA)

5

Limited commercialisation of innovation from Universities



### Mothership

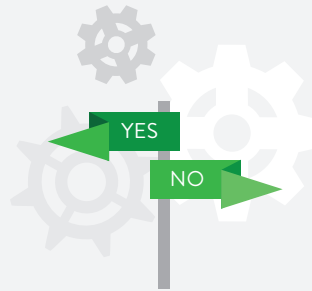
Limited incentives to assist transition from Mothership

Need right skills & support to create successful spin-offs

Tick box mentality: A result of current regulatory framework

Adverse selection of entrepreneurs

Too few 'intrapreneurship' programmes



### External Trigger

BBBEE Compliance rather than Commitment

Consequences of BBBEE: incentivising the wrong behaviour

Socio-economic and environmental challenges

Retrenchments

Exchange Control impact



### Local Hero

Inadequate formal entrepreneurship education

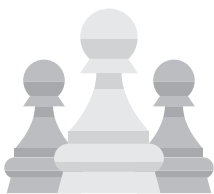
Insufficient celebration of non-tech, high-growth entrepreneurs

Limited media coverage

Limited number of role models

Celebrity status distracts from business development

## TOP CROSS-CUTTING ISSUES



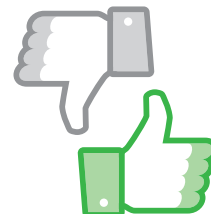
Skills Deficit



Hindering regulations and policies



Limited availability of venture and SME funding



Private & Public sector disconnects and trust deficit



Low tolerance of risk and failure

## SECTION 2

# Background

## 2.1 Introduction to SiMODiSA

The SiMODiSA Association is an industry association “by entrepreneurs for entrepreneurs”, which seeks to enhance the success rate of innovative and job-creating entrepreneurial ventures in South Africa. In order to achieve this, SiMODiSA implements a two-pronged strategy: 1) “accelerating entrepreneurship” by collaborating with policy makers to address key obstacles facing entrepreneurs by developing suitable policy changes based on industry feedback and global best practice; 2) Enhancing cultural recognition and celebration of entrepreneurs by “amplifying entrepreneurship”.

Representing key stakeholders from both the public and private sector, SiMODiSA explores the barriers that SMEs, start-ups and scale-ups face, and strives to catalyse entrepreneurship by research, policy design and stakeholder engagement. By addressing critical barriers (such as access to capital, access to markets, access to talent, and the lack of a supporting enabling environment) and defining actions for regulatory and policy amendments, supportive ecosystems are established that in turn enable businesses to grow and thrive.

SiMODiSA’s Entrepreneurial Amplification programmes seek to bridge the gap between investors and entrepreneurs by using effective programme mechanisms and ensuring that entrepreneurs are “investor-ready” through tools, training and networking forum events.

## 2.2 The Research Project

In collaboration with SiMODiSA’s research partner, the Impact Trust, and with the support of Omidyar Network Africa, FNB and SAVCA, a significant effort towards policy refinement through research, analysis and policy design commenced in 2013. This research and policy design programme seeks to: a) identify key constraints and policy measures that represent critical barriers to the South African entrepreneurial ecosystem; and b) refine and/or design policies specifically targeted to address these barriers. It seeks to meet the needs of both start-ups and scale-ups to ultimately transform the South African entrepreneurial ecosystem into a more enabling environment, one that supports both the creation and growth of job-creating enterprises. The process demands coordinated action and collaboration, hinging on stakeholder engagement with entrepreneurs, practitioners, industry leaders, academics and government officials to identify and design practical policy recommendations that are in line with South Africa’s National Development Plan (NDP).

In October 2014 the first phase of the research project culminated in an initial Position Paper that was the result of extensive stakeholder and expert engagement and analysis. The seven recommendations included in the initial Position Paper were informed by: desk-based research on existing local policy and international policy and precedent; policy design, including deeper engagement with key expert advisors and stakeholders, as well as engagement with government officials and policy makers to determine the design features and feasibility of recommendations; testing of the recommendations with the stakeholder group; and lastly, tabling seven specific sets of recommendations to the South African Government through National Treasury.

The Position Paper draws on four models of entrepreneurship that were identified through the Monitor Group’s experience in benchmarking surveys conducted in 22 countries and over 150 projects in regional development around the world<sup>2</sup>. These archetypes are associated with specific and often localised ecosystem enablers that contribute to their success. It should be noted, however, that they rarely exist in complete isolation, tending rather to overlap and intermingle within a local context. Notwithstanding, individually and collectively they are useful tools through which we can assess and describe the specific conditions in a given area. Based on this it is possible to develop practical, targeted strategies and policies to encourage entrepreneurship and ideal entrepreneurial ecosystems in that area, within a local context.

<sup>2</sup> Monitor Group. 2009. Paths to Prosperity, Promoting Entrepreneurship in the 21st century.

An understanding of these four entrepreneurial archetypes and how they might apply in the South African context is vital for identifying priority constraints that hinder a thriving entrepreneurial ecosystem and in turn will contribute towards shaping the policy recommendation agenda for 2015 and beyond.

## The four entrepreneurial archetypes can be summarized as follows:

### 1. High-tech Entrepreneurship Model<sup>3</sup>

Intellectual Property (IP) is developed at or near major research universities and research centres (government funded innovation) and is commercialised, often with the help of angel investors and venture capital.

Silicon Valley is considered the 'classic' example of this model of entrepreneurship, with other notable examples including Route 128 in Boston in the United States and Cambridge in England.

### 2. External Trigger Model

External events and/or circumstances trigger entrepreneurship, releasing many skilled and experienced people into the market, freeing them to start their own businesses. Entrepreneurial ventures become more feasible as a result of the sudden wealth of skilled, experienced workers in one place.

### 3. The Mothership Model

Businesses emerge from existing companies that spin-off smaller entrepreneurial ventures and / or employees who identify a commercial opportunity and set-up a new venture in order to pursue it. The 'mothership' or 'anchor firm' typically supports these smaller ventures as suppliers, customers or distributors.

This model is considered to be the most widely applicable, most especially in the context of the developing world where nearly every country has at least a handful of large private-sector or state-owned firms that could provide the impetus for entrepreneurial activity.

### 4. Local Hero Model

The success of a great local hero inspires others to start businesses (inside or outside the local hero's industry)<sup>4</sup>. The type of exceptional individuals typically required for this model tend to be outliers and consequently, this model tends to be pursued less frequently and is recommended in the absence of the building blocks for the other models.

<sup>3</sup> Originally dubbed 'the classic', Silicon Valley Model of high-tech entrepreneurship" by Monitor Group in Paths to Prosperity, this model has become typically referred to as "The Silicon Valley Model" in short. However, whilst engaging with stakeholders and using this short-hand term, it became clear that "Silicon Valley" becomes the only reference point, rather than providing a 'neutral' archetypal model as is intended and is the case with its counterparts. Consequently, we have elected to refer to this classic model as the "High-tech Entrepreneurship Model".

<sup>4</sup> Monitor Group. 2009. Paths to Prosperity, Promoting Entrepreneurship in the 21st century.

## SECTION 3

# Determining SiMODiSA's 2015 Policy Agenda

In order to realise an entrepreneurial ecosystem<sup>5</sup> where any of these archetypes will be able to thrive in South Africa, it is important to strengthen the following components that affect all entrepreneurial ecosystems and types of entrepreneurs:

1. A favourable regulatory framework;
2. Resources;
3. Market access;
4. Cultural support and entrepreneurial spirit.

In addition to these crosscutting components, recent research<sup>6</sup> identified the following enablers as key to the respective entrepreneurial archetypes:

Table 1: Key Enablers of the Entrepreneurial Archetypes<sup>7</sup>

ARCHETYPE	KEY ENABLERS
<b>The High-tech Entrepreneurship Model</b>	<ul style="list-style-type: none"> <li>• World-class universities &amp;/research centres (Govt.-funded innovation)</li> <li>• Community of Angel investors and Venture Capitalists (VCs) linked to above institutions</li> <li>• Efficient patenting &amp; licensing of new products</li> <li>• Education &amp; support for inventors to understand IP rights &amp; protection, how to approach funders &amp; commercialise products</li> <li>• Business skills support</li> <li>• Access to global markets and export potential</li> </ul>
<b>The Mothership Model</b>	<ul style="list-style-type: none"> <li>• Pool of large private sector or state-owned firms, particularly with a willingness to work with smaller firms and / permit their employees to pursue spin-offs</li> <li>• Talented/skilled executives within large corporates who have entrepreneurial edge</li> <li>• Incentives for large companies to create &amp; nurture spin-offs</li> </ul>
<b>External Trigger Model</b>	<ul style="list-style-type: none"> <li>• Government policy to mobilise these skills for creation of new businesses (e.g. B-BBEE – qualification for ED &amp; supply-chain access)</li> <li>• Availability of quick and efficient financing options for such businesses</li> <li>• Incentives, business skills training and complementary support to ease the transition to entrepreneurship</li> </ul>
<b>Local Hero Model</b>	<ul style="list-style-type: none"> <li>• Institutions &amp; media houses that emphasise putting the spotlight on successful entrepreneurs</li> <li>• Culture of celebrating entrepreneurship</li> </ul>

<sup>5</sup> When we refer to 'entrepreneurial ecosystems', we refer to the full range of participants involved in such ecosystems, from entrepreneurs themselves to those individuals and institutions that provide financial and non-financial support, or who shape policy and the broader environmental conditions. Furthermore, entrepreneurs and businesses included in this concept, span both start-ups and scale-up businesses.

<sup>6</sup> Endeavour South Africa. No Date. The State of Entrepreneurship in South Africa, The Key Archetypes of an Entrepreneurial Culture, 3rd Edition, White Paper: Deliberations and Key Findings. [www.endeavour.org](http://www.endeavour.org)

<sup>7</sup> Summary developed as composite of information sourced from Endeavour Report (Endeavour South Africa. No Date. The State of Entrepreneurship in South Africa, The Key Archetypes of an Entrepreneurial Culture, 3rd Edition, White Paper: Deliberations and Key Findings. [www.endeavour.org](http://www.endeavour.org)) and Paths to Prosperity (Monitor Group. 2009. Paths to Prosperity, Promoting Entrepreneurship in the 21st century).

### 3.1 Current South African Landscape

“Helping create new companies is one of the most important things a government can do to ensure a competitive economy.”<sup>8</sup>

To identify priority constraints that hinder a thriving entrepreneurial ecosystem it is also necessary to understand the South African context in which these four entrepreneurial archetypes and their key enablers function.

The NDP demands the creation of 11 million jobs over the next 15 years and a target economic growth rate of 5.4% per annum<sup>9</sup>. However, South Africa does not currently feature the levels of innovation, knowledge and research and development (R&D), supported by a healthy triple helix relational ecosystem<sup>10</sup>, which is typically associated with the type of sustained, long-term economic growth and competitiveness the NDP’s targets require.

South Africa’s entrepreneurial activity is in deficit. It is lagging behind other developing countries in the area of entrepreneurship. South Africa has the fifth lowest total early-stage entrepreneurial activity (TEA) rate of 7.0% amongst its counterparts with a similar level of economic development, categorised as “efficiency-driven economies”. Furthermore, it has the fourth lowest established business ownership rate across all 73 participating Global Entrepreneurship Monitor (GEM) economies<sup>11</sup>.

In addition to South Africa’s low levels of entrepreneurship, its overall business environment is unfavourable, burdened by unsupportive and disabling legislation. This is evidenced by South Africa’s ranking as only 41st in terms of the ease of doing business<sup>12</sup>. Local economic conditions, a lack of skilled staff, difficulty accessing finance, and burdensome regulations were cited as the four largest impediments to growth by firms participating in the 2013 SME Growth Index, produced by SBP<sup>13</sup>.

It is clear that in order to achieve the NDP goals of job creation and economic growth, considerable reshaping of the entrepreneurial ecosystem in which SMEs, start-ups and scale-ups operate is necessary. These businesses are increasingly being recognised as the primary vehicle of new job creation. The barriers to growth typically hit those SMEs that are poised to scale and realise significant job creation and economic development benefits hardest. Hence, it is imperative that the needs of SMEs, particularly those with growth potential, are prioritised and that their regulatory environment is transformed.<sup>14</sup> Without a policy environment that is conducive, our ambitious and important goals of developing thriving entrepreneurial ecosystems cannot be realised.

### 3.2 Dinner Conversations: The Platform for Engaging Thought Leaders

Phase 2 of the research project kicked off in October 2014. Sponsored by the Omidyar Network, FNB and SAVCA, SiMODiSA and the Impact Trust hosted a series of facilitated dinner conversations in Cape Town and Johannesburg, each with on average 10 key thought leaders and influencers.<sup>15</sup> The Cape Town thought leader dinners took place on the 29th and 30th of October, while the Johannesburg dinners took place on the 4th, 5th and 6th of November. Each dinner featured a slightly different focus on one of the specific archetypes and engaged industry thought leaders to identify priority constraints that inhibit the development of a thriving entrepreneurial ecosystem in South Africa.

The distinguishing element of the dinners was that the archetypes were the pivot around which issues were identified and considered. This enabled the research team to distil from the dinner conversations a suite of issues that are believed to hinder the archetypes’ success in South Africa. The objective process of analysis was intended to ensure that Phase 2 would be well-informed and well-positioned from the outset.

The research team facilitated each dinner based on the particular evening’s entrepreneurial archetype. Conversations were kept informal, guided by probing facilitator questions to ensure that diverse elements of each archetype were considered. The dinner conversations were distilled and analysed by the research team to identify the most pressing constraints relevant for each entrepreneurial archetype, as well as those constraints that are relevant for all types of entrepreneurs.

While providing the intended platform for engagement, the dinners also brought industry experts and “aggregators” of activity in the SME environment around one table, providing an opportunity to deepen networks amongst South Africa’s most influential entrepreneurial ecosystem players.

<sup>8</sup> Monitor Group. 2009. Paths to Prosperity, Promoting Entrepreneurship in the 21st century, p 18.

<sup>9</sup> Republic of South Africa. National Planning Commission: The Presidency. 2011. National Development Plan 2030: Our Future – make it work. National Planning Commission. Pg 9.

<sup>10</sup> The system of relationships and interdependent exchange process between the Government, research institutions (academia) and the private sector (industry)

<sup>11</sup> Singer, S.; Amorós, J. E.; & Arreola, D. M. 2015. Global Entrepreneurship Monitor 2014 Global Report. Global Entrepreneurship Research Association (GERA). gemconsortium.org

<sup>12</sup> The World Bank. 2014. Doing Business. Measuring business regulations. Doingbusiness.org

<sup>13</sup> SBP. 2014. SME Growth Index. Easier, Harder for Small Business in South Africa. SBP. Johannesburg.

<sup>14</sup> SBP. 2013. Developing a New Path for SMEs in South Africa. Reassessing for growth. www.SBP.org.za

<sup>15</sup> A schedule of thought leaders in attendance can be found in Appendix 1 of this report.



## SECTION 4

# Outcomes of the Thought Leader Engagement Process

In addition to the constraints identified and discussed below, the dinner conversations highlighted the importance of clear and consistently applied definitions of entrepreneurship. It was noted that one of the challenges when speaking of “SMEs” is the tendency for this to serve as a catchall term, thus referring to a broad range of businesses by scale, stage or type of entrepreneur (social, lifestyle, survivalist etc.). This is not ideal as each of these types and/or stages of business and / or entrepreneurs face different challenges. Accordingly, each requires nuanced support and intervention strategies. When engaging with the private sector and government, it is important to be cognisant of these different needs.

A consistent theme that emerged suggested that certain individuals may be considered outliers who are ‘entrepreneurial by nature’ i.e. willing to take risks and find a way to succeed despite any unfavourable environmental conditions that may exist. However, it is important to note that even the potential positive impacts yielded by these ‘true

entrepreneurs’ may be significantly hampered by an unfavourable operating environment, most especially at critical stages of growth.

Thus, while certain entrepreneurs may succeed in establishing a business that can survive, an unfavourable business climate, one that stifles competition and the capacity of new market entrants’ to compete with large business, could severely hinder their growth potential, thereby limiting positive contributions towards job creation and economic growth. It is thus important to consider persisting challenges in the entrepreneurial ecosystem in relation to the particular needs that emerge from different stages of the business life cycle: start-ups and scale-ups may be more or less vulnerable to policy at different stages of development.

The figure below contains an overview of the key constraints identified in relation to each archetype, as well as those crosscutting issues that affect all entrepreneurs<sup>16</sup>:

## TOP ISSUES PER ARCHETYPE MODEL

### High Tech Entrepreneurship

1 Skills deficit

2 Funding needs (Angel Networks; incentives; endowment)

3 Remote location and limited access to markets

4 Current government procurement limitations (PFMA)

5 Limited commercialisation of innovation from Universities

### Mothership

Limited incentives to assist transition from Mothership

Need right skills & support to create successful spin-offs

Tick box mentality: A result of current regulatory framework

Adverse selection of entrepreneurs

Too few ‘intrapreneurship’ programmes

### External Trigger

BBBEE Compliance rather than Commitment

Consequences of BBBEE: incentivising the wrong behaviour

Socio-economic and environmental challenges

Retrenchments

Exchange Control impact

### Local Hero

Inadequate formal entrepreneurship education

Insufficient celebration of non-tech, high-growth entrepreneurs

Limited media coverage

Limited number of role models

Celebrity status distracts from business development

## TOP CROSS-CUTTING ISSUES

1

Skills Defecit

2

Hindering regulations and policies

3

Limited availability of venture and SME funding

4

Private & Public sector disconnects and trust deficit

5

Low tolerance of risk and failure

<sup>16</sup> Appendix 3 contains a more detailed summary of the constraints, along with examples and suggested possible solutions for consideration.

#### 4.1 The High-Tech Entrepreneurship Model

San Francisco Bay's Silicon Valley, home to Google, Apple and Facebook, is considered the classic example of high-tech entrepreneurship. While the Endeavour White Paper<sup>17</sup> indicates that South Africa possesses the appropriate building blocks for the High-Tech Entrepreneurship Model, dinner participants cautioned against attempts to replicate the Silicon Valley example without proper consideration of the underlying drivers that contributed to Silicon Valley's success. Most importantly, whether and how these might be relevant and / or applied in South Africa's current context is worthy of consideration.

#### “We need to write our own story – from a South African context”

Johannesburg thought leader

The High-Tech Entrepreneurship Model was identified as a model that could provide a powerful demonstration of the potential to harness technology to provide local solutions to local challenges. It was suggested that pursuit of such a model should be grounded in South Africa's unique context, challenges and opportunities.

**Key constraints to the High-Tech Entrepreneurship Model, identified during the thought leader dinners, include:**

##### 1. Skills deficit

- Entrepreneurs need a myriad of skills to run and grow a business. In addition to the entrepreneurial skills and expertise needed to run and scale all businesses, businesses operating within the High-Tech Entrepreneurship Model are also dependant on a ready supply of tech skills, such as coders and developers.
- Currently there are insufficient numbers of institutions providing the necessary training and practical exposure required to support a thriving high-tech industry in South Africa. Limited numbers of available tech resources also means that these skills come at a premium, one which start-ups and scale-ups struggle to afford.
- In addition, Silicon Valley as an example of the High-Tech Entrepreneurship Model operates as an attractive hub that draws entrepreneurial, innovative talent from all over the world. As a result, immigrant entrepreneurs started significant numbers of Silicon Valley's most successful ventures.
- The state of South Africa's Department of Home Affairs and the uncertainty around current policy changes is a substantial deterrent for foreign entrepreneurial skill and talent that could add crucial value to South Africa with new job-creating ventures.

##### 2. Funding needs

- Entrepreneurs need access to Knowledge, Networks and Funding. Other countries have catalysed entrepreneurship by making it easier for private investors and government stakeholders to provide

funding and support especially with respect to the promotion of angel investor engagement (with concomitant benefits). South Africa is lagging behind, particularly in the area of early stage angel investors although it should be said that it was acknowledged that growth and expansion of VC activity should also be facilitated.

- Because of the higher elements of perceived risk, entrepreneurs cannot leverage traditional channels of funding for growth. In combination, the South African Venture Capital industry is fragmented and in its infancy.
- The lack of access to risk funding is severely inhibiting the number of start-ups and their potential for growth.

##### 3. Remote location & limited access to markets

- Access to international markets is critical to enable South African businesses to scale, particularly because of the limited size of the domestic market.
- South Africa is relatively geographically remote, rendering access to international markets difficult for local entrepreneurs. There is also limited support for entrepreneurs to access markets via partnerships with corporates, mentors and networks providing 'soft landing' opportunities.
- Growth of entrepreneurial ventures (especially in the business-to-consumer space) is consequently hampered.

##### 4. Current government procurement limitations (PFMA)

- Government procurement is complex and full of red tape. The current Public Finance Management Act (PFMA) is not appropriately crafted to enable procurement of entrepreneurial innovation by government departments, limiting the potential pool of support for enterprises.
- Entrepreneurs / SMEs should be able to access and bid on government procurement opportunities in a smooth and efficient manner. In the case of the High-Tech Entrepreneurship Model, this would more especially enable the application of tech entrepreneurship to solve service delivery problems.
- Whilst it is evident that the intent to support innovative enterprises is there, the current status quo means that opportunities for Government to do business with SMEs are lost.

##### 5. Limited commercialisation of innovation from Universities

- South African universities are patenting many innovations in multiple fields. However, few are successfully commercialised and there are poor linkages and few effective relationships between academia and industry.
- This poor quality of relationship is compounded by insufficient incentives to encourage research towards commercially viable products.
- Consequently, academia and industry are not collaborating and taking advantage of each other's complementary skills and strengths towards turning key innovations into commercially competitive advantages for South Africa.

<sup>17</sup> Endeavour South Africa. No Date. The State of Entrepreneurship in South Africa, The Key Archetypes of an Entrepreneurial Culture, 3rd Edition, White Paper: Deliberations and Key Findings. [www.endeavour.org](http://www.endeavour.org)

## 4.2 The Mothership Model

Large corporates and state-owned firms dominate South Africa's oligopolistic economy, representing a significant opportunity for these entities to act as Motherships and initiate / support meaningful numbers of spin-offs. In addition to the typical model based on corporate spin-offs, dinner guests highlighted that Government should not be overlooked as a possible Mothership.

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In order to develop appropriate strategies and solutions towards successfully realising a Mothership Model of entrepreneurship, the following key constraints would need to be addressed:

### 1. Limited incentives to assist the transition of enterprises from a Mothership

- Large corporates, state-owned firms and Government Departments and Agencies represent powerful potential Motherships from which to launch / spin-off new ventures and innovations.
- However, current policy and incentives, such as BBBEE and its Enterprise / Supply Chain Development tend to be narrowly framed, failing to speak to corporates to encourage or invest in viable incubation/acceleration techniques or to corporate employees to encourage them to transition from the comfort of corporate life.
- The lack of appropriate incentives consequently limits the potential for innovation stemming from corporates.

### 2. Insufficient skills & assistance applied to support/create successful spin-offs

- Entrepreneurs are typically in a relatively powerless position when engaging, and particularly negotiating, with big business. Those emerging from within the corporate culture specifically tend to be ill-equipped as entrepreneurs due to the characteristically compartmentalised nature of roles within corporate structures. Consequently, employees / ventures emerging out of corporate entities require targeted support and assistance to fully develop the requisite skills to prepare them for success.
- Currently there is little to no support for employees / SME's in developing these skills and creating spin-offs.
- At worst, the numbers of spin-offs are severely reduced and at best, they are not as successful as they could be.

### 3. Tick box mentality: An unintended consequence of the current regulatory framework

- BBBEE is input rather than output focussed, resulting in a tick-box mentality being most commonly applied. Indeed, given the regulatory pressures, corporates tend to be focussed on getting the maximum number of points with as little impact to their core business functions as possible. Consequently, rather than developing businesses to play a role within the corporate's value chain, as intended, Enterprise Development has been focussed on the development of non-core services such as cleaning, plumbing and security.
- While there is some merit in the development of all types of services, this approach has yielded poor results in terms of the real intention of transforming the face of entrepreneurship and corporate supply chain service providers.

### 4. Adverse selection of entrepreneurs

- Entrepreneurship succeeds when the best, most skilled people start and run innovative ventures. Most importantly, entrepreneurs must be driven by an intrinsic, passionate commitment to their venture in order to endure through years of hardship and sacrifice, most often with no financial reward ever materialising.
- Corporate and government programmes often aim to channel staff displaced through retrenchment programmes into entrepreneurship initiatives. This creates two 'adverse selection' outcomes: 1) systematically selecting people that are on average less skilled, hard-working, and passionate; and 2) selecting entrepreneurs who are entrepreneurs by necessity, not by choice.
- These ventures will enjoy a low success rate due to the adverse selection of relatively weak entrepreneurs.

### 5. Too few 'intrapreneurship' programmes

- Intrapreneurship can be an important step towards entrepreneurship and encouraging entrepreneurial characteristics, while benefiting the corporate employer. It can be one of the most efficient ways to 'train entrepreneurs' for the realities of pursuing and growing new ventures.
- There is too little intrapreneurship in South Africa. Few successful South African entrepreneurs stem from intrapreneurial backgrounds.
- This is an underutilised mechanism to create a pipeline of strong entrepreneurs.

### 4.3 The External Trigger Model

While there is a certain level of overlap between the Mothership and External Trigger models, particularly in the discussion of BBBEE, it is important to identify not only where these models intersect, but the areas where they are distinct and represent additional constraints and in turn potential opportunities for entrepreneurship.

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**Dinner guests identified the following issues as most pertinent to the External Trigger Model:**

#### 1. BBBEE Compliance rather than Commitment

- The BBBEE Codes of Good Practice's emphasis on Enterprise Development and Supply Chain Development is a material trigger for SME funding and support. Unfortunately the focus of corporates is more on ticking boxes than genuinely implementing an effective small black business support strategy.

#### 2. Unintended consequences of BBBEE – incentivising the wrong behaviour

- The GEM 2014 Global Report, referred to above, shows that South Africa has one of the lowest levels of TEA amongst economies in a similar stage of development and percentages of established business ownership in the world, but what is more telling is that South Africa is so far behind its peers in Africa. South Africa features a TEA rate of 7.0% and an established business ownership rate of 2.7%, while it's participating African counterparts average 26.0 and 13.2%, respectively.
- It is believed that this has been one of the unintended consequences of BBBEE because it is easier and less risky to get a highly paid job at a corporate that needs BEE candidates. If one is prepared to be entrepreneurial, it is easier to become a 'tenderpreneur', abusing connections to win government contracts, than to gradually build a successful and enduring business from the ground up.

### 3. Socio-economic and environmental challenges

- Small businesses are not currently encouraged or incentivised to develop innovative and profitable solutions to South Africa's socio-economic and environmental challenges. E.g. solving water potability problems in rural areas and providing off-grid alternative energy power.
- Small businesses could also be used to solve government service delivery issues in responding to these intractable issues, as well as broader government service delivery, such as software solutions for National Health patient management. Thus, changes in government procurement policies under the Public Finance Management Act (PFMA) could trigger significant small business opportunities.

### 4. Retrenchments

- Government and large corporates are retrenching vast numbers of people.
- Currently, these experienced and skilled resources are released into the market, with little to no opportunities for employment or appropriate support to establish ventures.
- As part of their retrenchment packages incubators / support programmes could be set up to assist retrenched individuals to not only reskill but also to set up their own businesses. As such, this Trigger could also form part of a company's or government parastatal's supply chain development process.

### 5. Exchange Control impact

- South Africa is one of the only countries in the world that has exchange controls. Unfortunately Exchange Control is a trigger that has had negative consequences, acting to discourage long-term incoming investment flows into the country and encouraging outflows of capital and intellectual property, which South Africa sorely needs to attract and retain.
- Fast growing small businesses need to access international markets, markets that are out of reach or limited by exchange control regulation. This has also served to drain capital from the country by encouraging local entrepreneurs to set up businesses outside the country and in many cases to emigrate to run their companies from offshore localities.
- Exchange Control also stops South African citizens from bringing back their offshore money and investing in local businesses.

#### 4.4 The Local Hero Model

A local hero is more than a role model; he or she is the entrepreneur who plays a vital role in driving aspiration amongst other potential entrepreneurs and has often succeeded against all odds.

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Dinner guests raised the following issues as constraints to the local hero model in South Africa:

##### 1. Inadequate formal entrepreneurship exposure and education

- The formal education system is internationally recognised as playing an important role in entrepreneurship education and training that informs the propensity for individuals to engage in entrepreneurial activity. This propensity and increased entrepreneurial activity in turn lay the foundation for a pervasive 'culture of entrepreneurship'.
- South Africa's inclusion of entrepreneurship education and training in formal primary and secondary school is inadequate, contributing to a persisting limited prevalence of entrepreneurship and in turn, lack of entrepreneurial culture.
- This, combined with the co-existence of a 'tall poppy syndrome' has a knock-on effect, limiting one of the key enablers cited for the Local Hero Model to flourish – a culture of celebrating entrepreneurs, their individuality, innovation and uniqueness.

##### 2. Insufficient celebration of non-tech, high-growth entrepreneurs

- Internationally, as well as locally to the extent that entrepreneurs are celebrated, there is a tendency to only highlight the success of tech entrepreneurs, and most specifically, entrepreneurs in the IT sector.
- Non-tech, high growth start ups should also be celebrated to provide a range of role models across sectors.
- Businesses in low-tech sectors such as manufacturing, agro-processing and call centres, equally represent opportunities for these fast-growing and value-adding job-creators, hence the Government's prioritisation of these industries along with tech-based industries.

##### 3. Limited Media Coverage

- In South Africa we celebrate sportsmen, actors and politicians – we don't celebrate our entrepreneurs. This limits the significant potential of our successful entrepreneurs to encourage dreams and a culture of entrepreneurship.
- As mentioned above, however, where entrepreneurs are lauded, the focus tends to be limited to those who are high tech entrepreneurs. However, we need to celebrate and showcase entrepreneurs from all fields of activity and illustrate the different requirements and skills that these different entrepreneurial roles call for so as to be as inclusive as possible, making apparent the different avenues through which entrepreneurship can be achieved.
- We need a concerted campaign using all forms of traditional and social media to celebrate the successes of our entrepreneurs.
- Think Big (sponsored by Standard Bank) is a great example but it was flighted at a disadvantageous viewing time and the format wasn't entertaining enough – we need to use the Ballroom dancing "competition" format with more emphasis on the background inspirational stories – perhaps even a small business 'soapie'.

##### 4. Limited number of role models

- Entrepreneurs are invariably "in over their heads" and require much mentoring to succeed. But entrepreneurship is often romanticised. Only successes are shared, with little focus on the difficulties and failures experienced along the way.
- As a result, there are too few success stories of entrepreneurs, and an unrealistically glamorous and 'cushy' picture of entrepreneurship, leaving many entrepreneurs inspired but not mentally prepared for the avalanche of roadblocks along the way.

##### 5. Celebrity status distracts from business development

- There is a risk that small business owners may get distracted as a result of their celebrity status – speaking engagements, mentoring youth, attending functions – preventing them from running their businesses effectively.
- There is also a business model of simply winning competitions (a culture of fund raising for "money to play") to raise funding rather than focusing on generating operating revenue.

## 4.5 Cross-cutting issues

There are a number of ecosystem constraints that are relevant to all four entrepreneurial archetypes. The most commonly identified constraints of a crosscutting nature include:

### 1. Skills deficit

- Economic development and job creation are driven by innovative ventures, which in turn, require highly skilled people –leaders, innovators, managers, and field staff. While there are exceptions, successful ventures are most often started by entrepreneurs older than 30, with at least 1 degree, and 10 years or more of work experience operating in an environment that provides management, leadership, and technical training and support.
- South Africa has a widely acknowledged series of skills gaps. These include: the Entrepreneurial skills required to start, grow, and scale new and innovative ventures; the Business ‘hard skills’ necessary to successfully manage these ventures (financial, marketing, legal etc.); and the technical skills necessary to deliver the businesses’ services (coders, developers etc.)
- Common results of the skills shortages include: high venture failure rate; low rate of success raising start-up and growth funding; and limited capacity to scale.

### 2. Hindering regulations and policies

- The legal and policy context should enable entrepreneurship by protecting private property, providing a stable environment, enabling contract enforcement, etc.
- South Africa has several regulations that undermine entrepreneurship by hindering access to critical resources such as talent and capital which create an unstable and unpredictable business environment, and erode the rewards of success. This both reduces the incentive to start new businesses, and increases failure rates.
- Key examples include: 1) Unduly restrictive exchange controls; 2) unfavourable labour legislation; 3) the unintended consequences of BBBEE legislation; and 4) the unintended consequences of the manner in which Enterprise Development policies are drafted.

### 3. Limited availability of venture and SME funding

- Capital is a critical ingredient for starting and growing new and early stage ventures. Innovative high growth firms are particularly capital hungry. However, venture and SME funding industries remain very underdeveloped without Government intervention, due to the poor risk / reward dynamics. In most countries that have high rates of innovative, job-creating entrepreneurship, Governments have played a significant role in proactively supporting the building of a venture funding ecosystem using developmental funding, together with private sector fund and investment management.

- South Africa’s Government has invested tremendous resources in stimulating venture and SME funding. However, the results have been poor. There are 3 primary causes: 1) over-reliance on Public sector management, which lacks the skills and is encumbered by too much bureaucracy and politics to be effective; 2) poor program design - which does not adequately incentivise private sector talent to invest their own capital, skills and experience in financing (and therefore supporting) SME’s; 3) government incentive programs are cumbersome, often rendering participation non-viable, notwithstanding generous financial support. For example, the Section 12J regulations continue to enjoy low take-up due to poor design and administration.
- Consequently, South Africa’s venture and SME funding ecosystem remains weak, both in terms of the financing options available to start-ups and early stage firms, and the skills of adequately skilled and experienced mentors to support entrepreneurs.

### 4. Private sector / Public sector disconnects and trust deficit

- Both the public sector and private sector have critical roles to fulfil in stimulating entrepreneurship. This requires many working relationships between State organs tasked with stimulating and supporting entrepreneurship, and private sector agents as entrepreneurship champions.
- Private sector entrepreneurship champions (including financiers, incubators, mentors, etc.) find working relationships with State agents dysfunctional. Requirements are cumbersome, processes are hyper-bureaucratic, and programs are fundamentally at odds with entrepreneurial realities. Many of the most highly regarded entrepreneurship champions have given up on engaging government programs and incentives.
- Without healthy working relationships, both public programmes and private initiatives deliver a fraction of their potential impact.

### 5. Low tolerance of risk and failure

- Innovation and entrepreneurship are inherently risky. Typically, innovators and entrepreneurs experience numerous failures on the way to success. This is a healthy part of the innovation journey. Therefore, a culture of entrepreneurship requires appetite for and a positive attitude towards gainful failures. However, there is a low tolerance of failure in South Africa, and a limited understanding of the concept of a process of repeated attempts (i.e. failures) before arriving at success.
- Risk aversion is also fostered by some professional and legislative practices, such as striking CA’s from the roll if they go insolvent, as well as a lack of tax breaks available to entrepreneurs for loss recovery.
- This undermines entrepreneurship in 2 key ways: 1) fewer people are willing to “risk trying” a new venture; 2) those who do are on average less skilled. The most desirable entrepreneurs – highly skilled people – prefer corporate office jobs to innovating and starting new ventures, in part due to the social and financial risks of failure.

## SECTION 5

# Conclusion

Broadly, there was consensus amongst participants that South Africa presents significant talent and potential for entrepreneurship. However, the entrepreneurial ecosystems operating in the country are sub-optimal, inhibiting the successful attainment of potential for innovation, enterprise development and successful small business growth.

This report, encompassing the key challenges to South Africa's entrepreneurial ecosystem identified through SiMODiSA's thought leader dinners, will be used to engage with relevant government decision-makers, departments and agencies towards shaping SiMODiSA's 2015 policy agenda. SiMODiSA intends to work with government partners to distil concrete areas for improvement in terms of policy refinement and development that can address these intractable barriers.

These issues should inform, and indeed be prioritised, in the agenda for collaborative efforts between the private and public sector to address the priority factors that inhibit the development of thriving entrepreneurial ecosystems in South Africa. The focus now must be on finding solutions and strategies that leverage the assets and building blocks that we do have, learning from international precedent, but always with application firmly rooted in South Africa's unique contexts to foster a truly enabling entrepreneurial ecosystem. This will create the basis for Phase 2 in SiMODiSA's journey: tackling these constraints.

## TOP ISSUES PER ARCHETYPE MODEL

### High Tech Entrepreneurship

### Mothership

### External Trigger

### Local Hero

1	Skills deficit	Limited incentives to assist transition from Mothership	BBBEE Compliance rather than Commitment	Inadequate formal entrepreneurship education	1
2	Funding needs (Angel Networks; incentives; endowment)	Need right skills & support to create successful spin-offs	Consequences of BBBEE: incentivising the wrong behaviour	Insufficient celebration of non-tech, high-growth entrepreneurs	2
3	Remote location and limited access to markets	Tick box mentality: A result of current regulatory framework	Socio-economic and environmental challenges	Limited media coverage	3
4	Current government procurement limitations (PFMA)	Adverse selection of entrepreneurs	Retrenchments	Limited number of role models	4
5	Limited commercialisation of innovation from Universities	Too few 'intrapreneurship' programmes	Exchange Control impact	Celebrity status distracts from business development	5

## TOP CROSS-CUTTING ISSUES

1

Skills Defecit

2

Hindering regulations and policies

3

Limited availability of venture and SME funding

4

Private &amp; Public sector disconnects and trust deficit

5

Low tolerance of risk and failure



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