

## THE ENTREPRENEURIAL DIALOGUES

# State of Entrepreneurship in South Africa



*Presented by:*



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First National Bank

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SOUTH AFRICA

*In association with the Gordon Institute of Business Science*





## THE ENTREPRENEURIAL DIALOGUES

# State of Entrepreneurship in South Africa

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## ENTREPRENEURSHIP IS AT THE HEART OF OUR BUSINESS TOO

Entrepreneurship is vitally important to the economic and social development of South Africa. Through innovation, entrepreneurs create new, competitive markets and businesses which lead to job creation and have a multiplying effect on the economy. Entrepreneurship empowers citizens and is required for any emerging market to move forward and successfully integrate into the global economy.

The South African government has recognised this contribution and therefore has the goal of establishing South Africa as an entrepreneurial nation that rewards and recognises entrepreneurship. FNB Commercial Banking supports this through our contribution and participation in enabling, growing and accelerating entrepreneurship in South Africa.

FNB Commercial is a proud partner of Global Entrepreneurship Week, a world-wide initiative hosted by Endeavor South Africa, a non-profit organisation that supports high impact entrepreneurs in 11 emerging markets, including South Africa. Together, we hope that ongoing activities around this week will raise awareness about the potential of entrepreneurship, and initiate further interventions and debate on issues pertaining to new venture creation.

In that vein, we take great pleasure in presenting the first in a series of *Entrepreneurial Dialogues* focusing on the State of Entrepreneurship in South Africa. This pioneering report is unique in the fact that it represents the combined view of government, private sector and academia – extracted from a series of meaningful exchanges and debate. We aim to begin a new era of innovative collaboration that will result in accelerated growth and enablement of entrepreneurs, delivering sustainable enterprises that have a positive impact on our lives and communities.

As a company with entrepreneurial spirit at its heart, FNB Commercial is committed to empowering and educating South African entrepreneurs to take advantage of the business opportunities present in our country.

### Iris Dempsey

CEO, FNB Commercial Banking

## APPROACH AND METHODOLOGY

This paper was a collective effort. It was written to reflect what was said in actual debates of the first “State of Entrepreneurship on South Africa” conference on 19 November 2009; it is not a mouthpiece to broadcast the views of Endeavor or FNB. In addition to the main “State of Entrepreneurship” panel that initiated the conference, five breakout sessions were held on the following topics:

- The Culture of Entrepreneurship
- Access to Capital
- Access to Skills
- Incubators and Support Organisations
- Enterprise Development and BEE

Each session was recorded in audio and video, and Gordon Institute of Business Science (GIBS) students were assigned to all breakout rooms with a mandate to take notes and assist the facilitators in making sure that each of the five discussions covered both “key issues” and “proposed solutions” for the theme.

In late January 2010, copies of the audio recordings and of the GIBS students’ notes were forwarded to Endeavor South Africa where staff members created the first draft of this paper. The Endeavor team read through the GIBS students’ notes and listened to the audio recordings of each session. Drawing from these materials, session by session, they organised the content into “key points of discussion” and “recommendations and insights” sections for the paper.

Because this exercise was intended to be collective, the Endeavor team sent a first draft of the paper to key panelists and experts for comment; the intention was to give these experts an opportunity to review the draft.

It is our hope that the first edition of this paper will achieve its objective of creating a useful collaborative platform for South Africans who are interested in enhancing the level of entrepreneurial activity in the country. We apologise in advance for any shortcomings and hope to improve on this effort next year.

**Adrian Gore**  
Chairman,  
Endeavor SA

**Malik Fal**  
MD,  
Endeavor SA

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## THE STATE OF ENTREPRENEURSHIP IN SOUTH AFRICA



### OVERVIEW

The first annual conference on the “State of Entrepreneurship in South Africa” was held on 19 November 2009, at the FNB Conference Centre in Sandton. This conference was part of a series of activities within Global Entrepreneurship Week (GEW), a Kauffman Foundation global initiative that strives to foster national debates on entrepreneurship around the world. In 2009, it is estimated that three million people worldwide, from 8 800 organisations, participated in 25 000 activities across 87 countries.

The headline panel of the FNB-Endeavor conference on 19 November was a mixture of policy makers, entrepreneurs, academics, and funding providers. Their mandate was to drive a general discussion on entrepreneurship in South Africa with the underlying goal to set the tone for the five subsequent breakout panels that were to follow later in the day.



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The most competitive nations are those that have the highest level of entrepreneurial activity. Small and medium size businesses tend to be the greatest creators of jobs and collectively, the greatest creators of wealth in emerging economies.

## KEY POINTS OF DISCUSSION

### • South Africa's entrepreneurial activity is improving but still lags behind

The most widely used measure of entrepreneurship is the TEA (Total Entrepreneurial Activity) or 'early stage entrepreneurial activity' Index. It measures entrepreneurial activity by looking at the percentage of the active population, people between 25 and 64, who are entrepreneurs in any given country.

South Africa's TEA in 2008 stood at 7,8%, which is greater than it was in 2006 (5%) but still lower than India-Brazil (11,5% – 12%), Colombia (24,5%), Mexico (13,1%) and even the United States<sup>1</sup> (10,8%). However in 2009, following the economic crisis, the level of early-stage entrepreneurial activity in South Africa dropped again to just over 5%. Within South Africa, sharp differences remain within demographic groups with Indians and Whites having the most entrepreneurs (1,6:1 and 1,7:1 respectively compared to the general population), while Blacks and Coloureds have fewer entrepreneurs (0,9:1 and 1,2:1 respectively compared to the general population).

This situation is considered to be particularly alarming in a context where South Africa's Gini coefficient, its national gap between rich and poor, has actually become one of the highest in the world (South Africa is at a Gini index of 57,8 compared to Brazil's 57). Finding ways to stimulate entrepreneurship in South Africa has become one of the country's Gordian knots<sup>2</sup>, and a critical goal in order to consolidate the democratic gains achieved since 1994.

### • Respect and recognition for the contribution of entrepreneurs is not sufficient in South Africa

Entrepreneurship is not yet recognised for

the impact, growth, and possibilities it can offer the South African economy, or for the impact it can have on unemployment and other social tensions in the country. There has been an influx of people from other African countries into South Africa, many of whom have become vibrant entrepreneurs; will this phenomenon create role models that will inspire the majority of South Africans to appreciate the role entrepreneurship can have in their own lives and in the communities they live in?

Many stakeholders from different elements of society are attempting to foster greater entrepreneurship in South Africa. Partnerships like the FNB-Endeavor partnership offer support, government bodies like the Department of Trade & Industry and the Small Enterprise Development Agency (SEDA) as well as private participants like the Rupert family and others offer funding, academic institutions like University of Cape Town, Gordon Institute of Business Science and the University of Witwatersrand offer skills. They all contribute towards this critical cause. However, these fragmented approaches do not appear to be producing acceptable results and greater effort should be put into trying to combine the various support structures. Emphasis needs to be placed on high-impact, high-growth entrepreneurs who can use these resources effectively and become role models.

### • Entrepreneurial activity drives economic growth and job creation

The most competitive nations are those that have the highest level of entrepreneurial activity. Small and medium size businesses tend to be the greatest creators of jobs and collectively, the greatest creators of wealth in emerging economies. In 1790, 90% of the United States population was self-employed, a fact that is commonly

thought to have been a major factor in the building of the world's largest economy. Many of today's most impactful global corporates began as small entrepreneurial ventures in America at about that time. In South Africa, as in other emerging economies, these potentially transformative entrepreneurial entities must be identified and nurtured now.

### • Aspirant and existing entrepreneurs face huge challenges and frustrations in South Africa

The country's financial and operating environment is not supportive of entrepreneurs, particularly in terms of regulations, policies and access to capital. The banking system remains the main source of capital to start and grow businesses, whereas in other emerging countries, different financial structures play this support role. Financial services groups like First Rand that have an entrepreneurial tradition and have spurred successful entrepreneurial ventures like Discovery and Outsurance, are trying to make a difference in this regard, but these efforts in isolation might not be sufficient to make a meaningful difference.

### • Entrepreneurial skills are severely lacking

Both formal (primary to tertiary education) and informal (home and social networks) educational structures do not impart entrepreneurial skills in South Africa. If Malcolm Gladwell's premise that it takes 10 000 hours (five to six years) of practice to master anything holds true, then much more needs to be done to nurture entrepreneurial skills in young people. This is why FNB Commercial is already involved in a series of pilot entrepreneurial programmes within the school and university environments. Other stakeholders must also get involved and find innovative and effective ways to address this challenge.

### • Successful entrepreneurs are "disrupters" who like to do things differently

Entrepreneurship is a challenging life choice; in the words of Discovery's Adrian Gore, "Becoming an entrepreneur is like jumping out of an airplane with silk worms instead of a parachute and hoping that they are over-achievers!" In order to cope with the trials and tribulations that pave the entrepreneurial journey, entrepreneurs must have an innate frustration at normality and a strong belief that they can offer beneficial products and services to their fellow men. This is not for everyone and in order to succeed, entrepreneurs must understand and leverage whatever special form of capital they can bring to the table; be it a special relationship with a person, access to a critical piece of information, or a unique knowledge and experience that gives them a leg up in the pursuit of a specific opportunity. What matters in the long run is what they do with that capital and how they transform it into a vibrant business. South African entrepreneurs, unfortunately, tend to suffer from the "me too" mentality and a propensity to imitate rather than innovate.

### • Entrepreneurs who focus solely on making money do not end up building GREAT businesses

People start businesses for different reasons; some to make money, others because they feel that they have something different to offer, many because they do not like the controls in corporate environments. Whatever their reasons, South African entrepreneurship icon Raymond Ackerman, paraphrased by facilitator Alec Hogg, argues: "Money should not be the main motivating factor in starting a business. People should go into business to work on something they enjoy and the money will follow." On the other hand, there is a notion that people who have been extremely success-

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It is important to note that the rewards of business success should be shared among the founding staff who took part in the risk associated with a new venture; a culture of co-ownership in the early stages is a critical success factor that is not always practised by South African entrepreneurs.



ful in business were never solely motivated by money but by passion. Warren Buffett who is the second richest man in the world and founder of the tenth largest company on the NYSE, still lives in the same house and drives the same car he had 45 years ago. So his original plan was clearly not about money although he ended up making lots of it. Finally, it is important to note that the rewards of business success should be shared among the founding staff who took part in the risk associated with a new venture; a culture of co-ownership in the early stages is a critical success factor that is not always practised by South African entrepreneurs.

• **Aspirant entrepreneurs in the townships battle to get started**

SABEF<sup>3</sup>'s 30 000 members are a truly representative sample of this tension. In the words of Lebo Gunguluza, "Our members are broke! We see many of them everyday who come to us frustrated at not even getting an opportunity to invest in a R2 000 video camera so that they can start a wedding video-filming business." Sometimes people just need a modest amount of support to get started and there is urgency in addressing such needs. At the same time, many successful businesses were started on the premise of a very good idea and very little money. Dr Mike Herrington

points out that a large portion of the Ernst & Young annual entrepreneurship competition finalists started with less than a R1 000 investment.

One key aspect to consider, based on the experience of institutions like SEDA, is whether the individuals who need funding have identified and are pursuing a genuine need, or are merely trying to imitate an already saturated business idea. In the words of Charles Wyeth from SEDA, "Our Tshwane branch happens to be just across the road from a CIPRO branch. At that branch, out of the 50 people we see every day, 40 are people who have just come out of CIPRO to register a business and immediately come to us asking for money and asking us what business sector they should get into! To us, these people are not entrepreneurs."

• **Most female entrepreneurs in South Africa seem to be lifestyle and not high-impact entrepreneurs**

The assumption is that men entrepreneurs can focus on their businesses more than women entrepreneurs who tend to have multiple commitments to balance in their lives. In addition, Dr Mike Herrington refers to a study that shows that South Africa's men:women ratio of entrepreneurs is 1,6:1 as opposed to 1:1 for countries like Peru and Chile.

Some of the reasons mentioned in the study for the gap between men and women in entrepreneurship are women's propensities to: want to spend more time with their families, want to avoid the stress of employing too many people, have less education, and experience more difficulty accessing capital due to marriage contract formulations. It was noted that if South Africa could bring its women:men entrepreneurship ratio to 1:1, the national TEA would significantly improve.

**RECOMMENDATIONS & INSIGHTS**

- Widespread "consumer" mentality, especially in the black community needs to give way to "productive" mentality.
- Main success factor in entrepreneurship is the 'psyche', meaning the passion and drive, of the entrepreneur.
- Entrepreneurship is critical for South Africa's future. In the short-term, the regulation and bureaucracy attached to starting businesses must be reduced. In the long-term, only broad educational reforms, at all levels, will change South Africa's entrepreneurial activity.
- Government is getting even more involved in entrepreneurship development (e.g. Khula direct initiative). It must do it in 'smart' ways while confronting some of the dysfunctional practices that are 'clouting' entrepreneurship in South Africa; tenderpreneurship, entitlepreneurship, funding without effective ongoing skills support strategies.

**OTHER ASPECTS TO CONSIDER**

• **Entrepreneurial activity drives economic growth and job creation**

Small business growth has been linked to economic growth, the creation of employment, and the alleviation of poverty. Furthermore, the Global Entrepreneurship Monitor report has conclusively shown that the level of early-stage entrepreneurial activity is directly related to per capita income. □

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NOTES

1. Data from UCT's GEM reports; The general assumption is that developed markets are supposed to have lower TEA's than emerging markets as a result of having a larger number of established companies.
2. A Gordian knot is derived from ancient Greek history in reference to very complex problems and situations.
3. South African Black Entrepreneurs Forum.



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## DEVELOPING A CULTURE OF ENTREPRENEURSHIP IN SOUTH AFRICA



### OVERVIEW

Culture matters when it comes to entrepreneurship. This panel explores the cultural status in South African entrepreneurship. It further explores objectives and aspirations to potentially change the current culture of entrepreneurship in South Africa. It proposes tangible solutions to the cultural challenges South Africa faces with regard to its level of entrepreneurial activity.

### KEY POINTS OF DISCUSSION

#### • Low tolerance for entrepreneurial failure

South African society does not appear to support entrepreneurs who have failed. People disassociate themselves from them, banks shut them down and the press demonises them. This culture, as can be expected, is not conducive to fostering greater entrepreneurial activity and should thus be confronted. In other parts of the world, like Silicon Valley for example, entrepreneurial failure is a badge of honour that is actually sought after by the financing community. Silicon Valley venture capitalists take pride in supporting people who have learnt from their mistakes. In the words of typical Silicon Valley Venture Capitalists, "When we look at a funding application, a very important factor for us is whether the entrepreneur has failed before because the greatest learnings on how to run a business come from having failed before!"

#### • South Africa has an entrepreneurial 'base' of high-impact entrepreneurs

Every country, including South Africa, has a core group, or base, of high-impact entrepreneurs. How a country supports, celebrates, and develops that 'base' determines its culture of entrepreneurship and ultimately, the future of its economy. In South Africa there is a country-wide intention and effort to support entrepreneurship, which is apparent, among other things, through the Black Economic Empowerment (BEE) policies and other similar types of initiatives. However, despite such efforts entrepreneurship is not as "activated" as it should be and bringing attention to the country's 'base' of high-impact entrepreneurs is a great starting point to address this problem.

#### • The Infinity of wealth

An important component of peoples' desire for free enterprise is determined by whether they view, consciously or unconsciously, wealth as being finite or infinite. People who view wealth as finite, as a zero sum game, tend to focus more on transactional, clientele-based career choices. For them the path to wealth is about connecting with the right crowd, gaining access to a share of a fixed pie, seeing the world as a static dichotomy of 'haves' and 'have nots' and ensuring that they are among those who have. When people view wealth as infinite, they search for opportunities and ways to make a difference for themselves and for the world. Their desire to innovate and create wealth from new ideas becomes stronger and they no longer spend their energy on trying to gain access to finite riches; a diamond mining concession, a BEE deal, or a marriage into one of their town's wealthy families. Both types of mental models (on whether wealth is finite or infinite) exist in South Africa, but the one based on the infinity of wealth needs to be proactively fostered.

#### • Pre-existing values, foreign experiences and a home grown culture of entrepreneurship

Culture is a very difficult thing to change; it is something that is embedded in peoples' psyches and behaviours. As South Africans seek to develop a culture of entrepreneurship, they need to build on pre-existing values and behaviours rather than try to emulate foreign habits and beliefs regardless of what the local norms are. For example the western culture of entrepreneurship based on the "rock star" worship of entrepreneurs may not be well-suited for South Africa where communal values are more the norm. Having entrepreneurial role models is important, but instead of looking at individual role models, South Africans should realise that great companies are the making

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Social science academics and entrepreneurial careers are not considered to be the “golden path” and as such do not always attract the best and the brightest. Such values and behaviours need to be confronted and changed at homes, in schools, and at universities.

of a collective, and not of an individual role model. Through that, young South Africans will hopefully learn to work with others in creating entrepreneurial ventures.

• **Corporate careers are still more desirable in South African Society**

South African society still, by and large, honours maths and science academic achievement and corporate careers. Social science academics and entrepreneurial careers are not considered to be the “golden path” and as such do not always attract the best and the brightest. Such values and behaviours need to be confronted and changed at homes, in schools, and at universities. They restrain entrepreneurial activity and entrench stereotypes about the kinds of backgrounds entrepreneurs should or should not have. The reality, of course, is very different from the perception.

• **Attitudes and language towards wealth and towards the wealthy**

Common South African manners of speech such as ‘filthy rich’ or ‘stinking rich’ denote a sense of resentment towards the rich. They somehow attach a negative energy to the pursuit of wealth, and to those whose self-declared purpose in life may appear to be the pursuit of wealth. Some have argued that South Africans have been deeply affected by years of conservative Christian values that exalt austerity, self-sacrifice, and even poverty as important factors of salvation. Others say that what has been done can be undone through leadership and national debates about how South Africans should define success. Whichever way these discussions go, entrepreneurship and the journey towards greater entrepreneurial activity should be separated from such existential issues. Entrepreneurship is the answer to many social ills South Africa faces right now, and the longer it takes to imbed a wider and deeper culture

of entrepreneurship the greater the danger will be that the painfully-gained South African democracy will fail.

• **South Africa’s sub-optimal transport infrastructure impairs the culture of entrepreneurship**

Part of the historical legacy of this country is that to this day, an estimated 10 million South Africans still do not have access to transportation and are thus confined in their physical movements. This reality is a major impediment to entrepreneurship. Mobility increases peoples’ exposure to new concepts and ideas; in turn, exposure to new concepts and ideas drives one’s sense of experimentation and innovation. As more and more South Africans travel within and outside South Africa and get exposed to new concepts and ideas, entrepreneurial activity should increase. In fact, between 2006 and 2008, the growth in South Africa’s TEA index from 5% to 7,8% suggests that entrepreneurial activity has increased,

but many other factors have also contributed to that increase.

**RECOMMENDATIONS & INSIGHTS**

- The entrepreneurship-limited values that currently prevail in South Africa can and must be ‘unlearned.’
- South Africa can learn from the experience of other countries to foster its own culture of entrepreneurship: celebrating role models, promoting an effective venture capital and private equity community, providing structures for entrepreneurial education and skills-support. However, local norms must also be taken into account.
- Foster a culture of entrepreneurship in homes, schools and universities.
- Include entrepreneurship in science-related fields of study.
- Recessions provide business opportunities; policies must be formulated to encourage and support would-be entrepreneurs.

**OTHER ASPECTS TO CONSIDER**

• **South Africa’s entrepreneurial ‘base’ of high-impact entrepreneurs**

It is questionable whether the South African government’s efforts to support entrepreneurship have worked. These government policies might have merely transferred wealth from one minority group to another.

• **Attitudes and language towards wealth and towards the wealthy**

Some of the derogatory terms towards the wealthy such as ‘filthy rich’ are not specifically South African; they are used elsewhere in English-speaking countries.

Therefore the assumption that South Africans have a more, or less, positive attitude towards wealth and towards the wealthy is not correct if based on this particular cultural trait. □

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## ACCESS TO CAPITAL



### OVERVIEW

There is a general perception amongst entrepreneurs that access to capital is a major inhibitor to entrepreneurial growth and activity. The general misconception is that this is a result of scarcity of funds available to funding institutions. A recent Global Entrepreneurship Monitor study revealed that South Africa is no worse or better off than any other country in terms of the availability of capital. This section aims to identify and catalogue many of the factors that may determine the availability of capital to entrepreneurs. Although one may still be in doubt as to where the drawback lies, funding is available in abundance in South Africa and the issue of scarcity is more a myth than a reality.

### KEY POINTS OF DISCUSSION

The key points of discussion detail the various problems and obstacles that are associated with access to capital in South Africa. There is an underlying theme of an existing 'perception gap' in these findings.

- **Discrepancies in matching between funding mandates and entrepreneurs' eligibility**

The fit between the capital providers' criteria and the businesses that are seeking capital is often problematic. In many cases, large disparities exist between the economic and financial status of the business seeking capital and the requirements of the various financing options that are made available by different funding groups.

Entrepreneurs tend to submit applications that are inconsistent with the funder's mandate. Venture capital funding is expensive; as a result, venture capitalists are generally not willing to assume too much risk. In South Africa entrepreneurs tend to seek sums of funding without the required business size and sophistication as collateral to back up their applications. Applications of this nature often do not comply with the funder's mandate. Furthermore, entrepreneurs often fail to source funding from alternative sources such as smaller scale equity investors who will not take as high an equity stake as a larger venture capitalist. A case study given is the Venture Capital arm of the Industrial Development Corporation (IDC), where many businesses seeking funding tend to apply for under R1 million which is below the IDC's mandate of equity funding range of R1 million to R15 million. Note that the reluctance of venture capitalists like the IDC to fund under R1 million is due to a lack of security and collateral and the sheer volume of applications that fall under their mandate range.

- **Oversupply of entrepreneurs in highly saturated markets and industries**

Funding agencies are often approached by entrepreneurs operating in highly saturated markets that are not easy to differentiate; these types of businesses are less attractive. The issue is not that the entrepreneur or his business is not viable enough, but rather that under such market circumstances it is more difficult for entrepreneurs to present unique business models and opportunities. This problem is mainly attributable to a lack of confidence in returns from such markets due to their saturation levels.

- **Lack of awareness and preparedness amongst entrepreneurs**

The issue is not so much a lack of access to capital but the stringent and lengthy process required to access funding. This is exacerbated by the general lack of awareness about the procedures and the courses of action involved in gaining equity funding, which leaves entrepreneurs under-prepared and under-researched. The application process tends to be bureaucratic and heavily laden with protocol and red tape as funders endeavour to gain confidence and assurance when granting funding to entrepreneurs.

- **Expectation management amongst entrepreneurs**

Expectation management presents a challenge to the funding process because many entrepreneurs expect the process of getting funding to be quick and easy. Such expectations are unrealistic. Unprepared applicants often end up frustrated and disappointed with the process. This is not to promote pessimism about the process but to encourage preparedness, pragmatism and practicality when considering funding instruments.

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Different funding agencies need to understand what drives the industries they invest in. Based on that knowledge, funding providers should offer instruments that are tailored to specific industries. These instruments should also extend support services to entrepreneurs at different levels and skill sets.

- **Over-emphasis on capital as the key enabler to entrepreneurial success**

There is a general lack of understanding of the entrepreneurial process. Many entrepreneurs are under the illusion that capital is the most critical catalyst for business success. Between 2008 and 2009, there has been a 40% decrease in the amount of entrepreneurial activity in South Africa. This is partly attributable to the effects of the global economic downturn and the fact that there was less investment capital available. However, the lower level of entrepreneurial activity could have been attributable to other factors. It is true that capital is essential and plays a key role in the ability of a business to progress; however, capital is not the only catalyst for success. The entrepreneur plays the most important role. In theory, there is an array of factors that dictate the conditions and circumstances under which a business should thrive. But, in reality, it is the ability of the entrepreneur to identify these factors and take appropriate courses of action that ultimately leads to the success of the business. In short, it

is a matter of skill and aptitude.

### RECOMMENDATIONS & INSIGHTS

- **Proactivity amongst entrepreneurs**

First and foremost, an entrepreneur needs to be meticulous and proactive. Venture capital firms encourage entrepreneurs to formalise market strategies and business plans and to conduct comprehensive research when formalising these plans. There is a wealth of information at the fingertips of all entrepreneurs. They should use the internet and mass media to gain a complete understanding of the dynamics of the market within which their business operates.

It is also important to investigate alternative forms of funding that may be available, and use the information gathered effectively. They should take time and implement necessary changes to the operations of their business to ensure that they are ready and eligible to meet the mandate of a prospective funder. Information is essential in making the right critical decisions.

- **Greater understanding by funders and involvement in target industries**

Different funding agencies need to understand what drives the industries they invest in. Based on that knowledge, funding providers should offer instruments that are tailored to specific industries. These instruments should also extend support services to entrepreneurs at different levels and skill sets. For instance, the nature of funding requirements in the construction industry will be very different from those in the retail industry. There is a need to take a more direct approach to address the perception gaps between funders and the entrepreneurial community. This could be achieved by engaging with selected groups of entrepreneurs who can provide feedback on their experiences in trying to access capital.

- **Improved communication between funding institutions and entrepreneurs**

Capital is available in South Africa and entrepreneurs need to discard the rather misguided belief that there is no money to fund

good projects. To address one of the bigger problems faced in the issue of access to capital (which is the general lack of information available to entrepreneurs), there is a pressing need for an increase in communication between the different funding vehicles and their prospective clients. This will require effort from both parties.

Funders need to communicate, in simpler terms, what their funding requirements are. Entrepreneurs need to understand these requirements more clearly in order to prepare themselves and produce business plans that address the needs of funding providers. This will help to close the prevailing perception gap within the entrepreneurial community about availability of capital and access to funding. The onus falls on both parties to make these efforts.

- **Greater financial education at grassroots level**

In the long-run, part of the responsibility for providing financial education at grass roots levels and reducing financial illiteracy in South Africa lies with the government and other relevant parties. This will boost the sophistication and capacity of prospective entrepreneurs in the future.

### OTHER ASPECTS TO CONSIDER

- **Expectation management amongst entrepreneurs**

Too often business plans are completed by service providers who have no knowledge of the business involved. The problem facing financiers is that the entrepreneurs themselves do not always understand their own projects nor do they understand the business plans completed by third parties. This is one of the main reasons why potential funders are unwilling to fund such applicants. □

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## ENTERPRISE DEVELOPMENT & BLACK ECONOMIC EMPOWERMENT



### OVERVIEW

The Broad Based Black Economic Empowerment Act (B-BBEE) was passed into law in 2007, as an amendment to the Black Economic Empowerment Act of 2003. This resulted in additional codes, such as Enterprise Development (Code 600), being included in the scorecard. The main objective of this code is to support and grow emerging black owned business. Enterprise Development currently makes up 15% of the overall B-BBEE scorecard.

Enterprise development (ED) requires South African corporates to spend 3% of their annual profits on support for black owned enterprises. This can be done either directly or by pledging funds to ED agencies that work with eligible companies. There is an estimated R12 billion in potential funding available for black businesses. Enterprise development has great potential to increase job creation and bring more black entrepreneurs and businesses into the mainstream economy. The reality is that it is a long way from achieving its intended aims for reasons that will be covered in this section. This section assesses the challenges of ED as an instrument for fostering black economic empowerment. It highlights the challenges different stakeholders face with ED. It also suggests possible solutions that will improve ED and ultimately increase job creation in South Africa.

### KEY POINTS OF DISCUSSION

- **Confusion about the purpose of ED within the B-BBEE regulation context**

Enterprise development is generally misunderstood because it is a relatively new legislation. In addition, the general lack of understanding and uptake is partly attributed to negative perceptions of BEE. The positive aspects of the BEE codes are often clouded by perceptions of corruption, misappropriation of tenders, and nepotism. Previously, awarding of tenders was based on company ownership and procurement, which opened up avenues for 'showboating' and other corrupt practices. These malpractices have led to pessimism and confusion about BEE and B-BBEE.

On the other hand, there has been insufficient communication about ED for entrepreneurs. Many are unaware that it is a

possible avenue for funding and even less aware of the procedures and requirements involved in securing ED funding.

- **Ineffective incentives for corporates to embrace ED**

There is a perceived lack of interest in ED in the corporate sector for a number of reasons. Firstly, ED is positioned as a social objective rather than a commercial exercise that could be rewarding for both entrepreneurs and the corporates who provide funding. The social positioning currently presented to corporates does not seem to resonate well. As a social objective, ED goes against the principle of maximising profits and there is no buy-in from top management as ED tends to be viewed as a burden.

The task of managing ED is often assigned to the Human Resource or Finance departments, which do not always have the technical knowledge required to administer ED funds appropriately.

The current mindset of management is to get as many points as possible, with minimum effort, time, and resources put into ensuring that ED funds are appropriately disbursed.

- **Majority of applicants lack the skills to realise the promise of ED**

One view states that there is a mismatch between the types of entrepreneurs who meet the requirements for ED and those who are applying for ED funding. ED funders are approached by entrepreneurs who often lack the skills and experience to best use the resources. There is an under-supply of suitably qualified and skilled black entrepreneurs. These potentially more attractive entrepreneurs are often in corporate jobs, with attractive salary packages, lured by corporates who have to satisfy the 'skills'

There is an under-supply of suitably qualified and skilled black entrepreneurs. These potentially more attractive entrepreneurs are often in corporate jobs, with attractive salary packages, lured by corporates who have to satisfy the 'skills' section of the BEE Codes.



How can we help you?



When ED is positioned to resolve a social problem, it is inefficient and unsuccessful; a grave unintended consequence is that it makes entrepreneurs over-dependent on corporate 'handouts'. When South African corporates see the commercial rewards of a successful ED programme, top management will be more willing to include it in their business planning, budgeting and other business processes.

section of the BEE Codes. By and large, the availability of funding is not the primary constraint; the difficulty is finding competent entrepreneurs and good enterprises.

• **Enterprise development's sole focus on funding is insufficient**

On the other hand, there is a fundamental view that ED does not cater for the majority of existing black entrepreneurs who lack business skills. Over and above funding, these entrepreneurs need support and business training. Without skills development, the likelihood of these entrepreneurs creating competitive and sustainable businesses is slim.

**RECOMMENDATIONS & INSIGHTS**

• **Enterprise development incentives for corporates**

It is imperative for corporates to understand that ED can be much more than just a social investment. It can be a profitable exercise that can add significant value to the business. Interesting business case

studies conducted in the US and the EU have shown that ED can be successful. For example, Investments in a company's value chain improve competitiveness, cost efficiency and quality – which all ultimately improve profitability. Corporates could have a lot to gain by applying this approach to their ED funding.

When ED is positioned to resolve a social problem, it is inefficient and unsuccessful; a grave unintended consequence is that it makes entrepreneurs over-dependent on corporate 'handouts'. When South African corporates see the commercial rewards of a successful ED programme, top management will be more willing to include it in their business planning, budgeting and other business processes.

• **Outsourcing as an option for ED function**

Enterprise development is a technical process that requires specialised skills. Corporates do not always have these technical skills in-house. A short-term solution would be for corporates to outsource the ED func-

tion to agencies that understand the legislation and can invest in the right enterprises.

There is however, a risk that in the long-run, outsourcing this function will mean that ED will become increasingly separate from core business operations. But, in the short-term, outsourcing provides a good option for many corporates which don't yet fully understand ED.

• **Reform the B-BBEE Codes**

Although Enterprise Development and Preferred Procurement constitute 35% of the BEE scorecard, many corporates and government tender processes still mostly focus on 'company ownership'. So far, to a large extent, most corporates are compliant with the 'ownership' requirements of the scorecard. The B-BBEE codes therefore need to evolve towards putting more emphasis on ED. One suggestion is that government should put less emphasis on the 'ownership' and 'employment' sections of B-BBEE and place higher allocations of points to ED. This will make the desire to invest in ED more financially attractive to corporates. They could be eligible to bid for tenders based on their level of ED compliance rather than their level of ownership. Incentives of this nature would make more 'business sense' to companies, as well as reduce corruption in the tendering process. Above all, rejigging the codes could provide the commercial case that is needed for companies to be more actively supportive of ED.

Furthermore, ED has the potential to give a much-needed boost to job creation. Currently, it is not being used to its full potential due to a lack of communication, a lack of skilled entrepreneurs, and a lack of incentives for corporate South Africa to truly adopt the concept. With suitable interventions such as improving communication and education on ED, creating the right support

for black entrepreneurs and providing the right incentives for corporates, ED could be an important tool to fast-track economic development in South Africa.

**OTHER ASPECTS TO CONSIDER**

• **Imperfections notwithstanding; BEE Codes should be revised infrequently and with great caution**

While our current regulatory framework may not be ideal, regulatory stability creates the context within which innovation and progress can take place. Frequently, changes in regulations prevent successful models from reaching maturity, demonstrating effectiveness, and being replicated. It is therefore destructive for BEE and socio-economic development to revise the codes more frequently than every five to ten years, particularly in areas such as ED, which are long-term. Codes should be revised infrequently, and with great caution.

• **Implementation of ED must not be treated lightly, or it will simply fail**

Enterprise development has been embodied in various business models around the world, including micro-finance, venture capital, private equity, and commercial lending (each having models that include strong technical assistance). These models are effective when driven by real businesses with appropriate skills, experience and dedicated capacity. For example, SASOL will need to spend >R1 billion on ED by 2015. A R1 billion fund would take 10 years to invest if staffed by at least 20 investment professionals, earning on average between R800 000 and R1 million each. ED programmes which do not gear up to select the right enterprises to support and structure the relationship for success, and support the enterprises over time, will simply squander valuable resources. □

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How can we help you?







## INCUBATORS AND SMALL & MEDIUM ENTERPRISE (SME) SUPPORT



### OVERVIEW

Business incubators assist emerging companies survive and grow during the start-up period, when they are most vulnerable. This assistance comes in the form of mentoring, networking, funding and access to physical facilities. The incubation process improves the survival rate of start-up companies by assisting them to become financially viable, usually within two to three years. Incubation also creates a synergistic environment where entrepreneurs can share learning, create working partnerships and act as enablers to access markets and resources.

Incubators have been in existence since the 1950s, but it is only in the 2000s that for-profit incubators started to emerge.

Within the for-profit incubator environment, even specialised incubators known as “accelerators” have emerged, focusing primarily on the IT industry. There are 7 000 incubators around the globe. Classically, in a tough economy, when the unemployment rate rises, more people turn to necessity-driven entrepreneurship and incubators are well positioned to assist them.

### KEY POINTS OF DISCUSSION

The important aspects of incubation are innovation and knowledge, particularly in today's knowledge-based economy. In this context, knowledge refers to the experience, data, technology, networks, and transfer of accumulated information that flows to the entrepreneur. Innovation is about new ways of increasing resource yields and efficiencies.

#### • Effectiveness of incubators is a matter of perspective

The broad question of whether incubation works depends on one's perspective. If you see incubation as a need to provide some form of support to early stage businesses and encourage entrepreneurship, then South African incubators are providing some benefits to the community. If you see incubators as enablers for the creation of hundreds of South African ‘Googles’, then incubation in South Africa is not working.

Effective incubation requires the selection of the right entrepreneurs through processes that target high-impact<sup>1</sup> businesses and high-impact entrepreneurs.

#### • The Small Enterprise Development Agency (SEDA) case study

SEDA is an agency supported by South Africa's Department of Trade & Industry.

The guidelines it has to deliver on are very specific:

1. Ensuring growth
2. Creating better equity in the economy
3. Supporting employment creation

On the criteria of growth, equity and employment, SEDA's 27 incubators are phenomenally successful as a vehicle for supporting small enterprise development. However, the drawback, in South Africa as in other emerging countries, is that incubation is expensive. It is expensive because good incubation deploys large amounts of resources to support few truly promising entrepreneurs.

In addition, an intensive selection process needs to take place to determine which entrepreneurs or businesses should be allowed to receive incubator services.

In assessing the success of incubators, the key criteria for survival rates need to be analysed. Generally small businesses or start-ups fail at a rate of about nine in ten in the first two years of operation. Within the 27 SEDA incubators, the survival rates are in the region of 84% to 97% in the first two years of operation depending on which incubator it is. Post-graduation from the incubator, the numbers do come down but they are still in excess of 70%.

In terms of wealth creation, the 200 companies incubated by SEDA generated a total turnover in excess of R129 million, with about 10 000 jobs created in 2008. These numbers were achieved largely due to SEDA's networking and lobbying in support of the incubated companies to secure government business.

The one area where SEDA is failing is in Initial Public Offerings (IPOs). In the past six years, SEDA has not had one IPO, whereas

In assessing the success of incubators, the key criteria for survival rates need to be analysed. Generally small businesses or start-ups fail at a rate of about nine in ten in the first two years of operation. Within the 27 SEDA incubators, the survival rates are in the region of 84% to 97% in the first two years of operation depending on which incubator it is.



How can we help you?



From a functional standpoint, the real value of incubators lies in entrepreneurs having access to specialised services such as legal and financial at the early stages of their businesses when they cannot afford to acquire those services directly.

Maxum, an incubator at the Innovation Hub supported by the Department of Science & Technology, has had two. This is an indication of the type of companies that are selected by these respective incubators.

SEDA has a broad public mandate and therefore cannot be too selective about the companies it supports. Maxum, on the other hand, has a much more specific selection process; it targets high-growth, high-potential businesses with a high level of technology usage. Given South Africa's historical context, the outcome of Maxum's selection criteria is often that the companies selected are primarily white-owned companies with a higher level of skill and expertise than the SEDA-incubated businesses.

- **Access and visibility of incubators – targeted communications**

In South Africa, incubators have not had the desired accessibility, prominence or openness to young entrepreneurs. They could be playing a more active role to help entrepreneurs overcome the business challenges they face.

The visibility of incubators to entrepreneurs-at-large remains an issue. Communicating as a medium for incubators is expensive and thus prohibitive. Another challenge is that incubation is not appropriate for all types of business; therefore it needs to be communicated in a targeted manner. An incubator has the capacity to efficiently service 40 to 60 businesses a year, which means that it has to be highly focused in terms of how it reaches the desired target market. In South Africa, the majority of incubators operate in specific sectors such as, ICT, Stainless Steel, and Biotechnology.

- **Service offering of incubators – peer support and experts**

Incubators provide the basic infrastructure,

learning, mentoring, executive coaching, functional support, networking and sales opportunities entrepreneurs need. However, the driver of success for incubators is the capacity to help entrepreneurs gain access to peer-to-peer learning communities. Good incubation is also about fostering communities of like-minded entrepreneurs.

From a functional standpoint, the real value of incubators lies in entrepreneurs having access to specialised services such as legal and financial at the early stages of their businesses when they cannot afford to acquire those services directly. Another important value-add of incubation is the mentoring and coaching where entrepreneurs have access to people who can act as sounding boards, look at their businesses critically and offer invaluable advice. Incubators are geared to assist in the elimination of key barriers to entry that entrepreneurs face.

- **Required skills within incubators to serve small businesses; high skills are expensive**

One of the challenges that incubators face is attracting technically skilled employees who can best assist the entrepreneurs. Small businesses tend to have multiple problems at any given time, with many pressing issues to deal with simultaneously. Handling such complexity requires highly qualified people. Thus, incubators must have sufficient financial resources to employ qualified and highly skilled employees. It is imperative for incubators to be financially viable and able to employ highly qualified employees who can provide entrepreneurs with very scarce skills.

A key measure of success is the incubator's own growth which demonstrates its ability to deliver value to SMEs. In the United States and Britain, most incubators are

attached to tertiary institutions that subsidise the cost of the senior skilled personnel. In South Africa, when incubation services are offered to SMEs with a limited ability to pay, the government should get involved and find ways to subsidise these costs for eligible SMEs. However, if the incubation is being offered to high-potential, high-growth SMEs, these SMEs should have greater ability to pay, which, in turn, will improve the sustainability of the incubator. There is no doubt that with the assistance of government funding, incubators can become more effective in delivering services to SMEs without the pressure of having to worry about their own financial viability.

## RECOMMENDATIONS & INSIGHTS

- **Greater understanding of the service offering of incubators**

Entrepreneurs need to have a very clear understanding of what their business requires before seeking incubation support. Part of the entrepreneurial process is about being resourceful in seeking the most appropriate solutions to specific problems. As incubation ultimately results in the creation of a business partnership, it is absolutely vital for entrepreneurs to do the necessary research into the various incubation options available.

- **The role of the education system in preparing entrepreneurs for incubation**

One of the challenges of South Africa's education system is the poor quality of entrepreneurial skills training at schools. There may be two ways to address this problem. One is to expose tertiary students to existing incubators in their communities, thereby making them aware that help is available should they decide to start a business. The other is to provide

entrepreneurial skills training at the tertiary level to elevate the quality of entrepreneurs that come into incubators.

- **Access to skilled mentors and coaches**

Gaining access to more skilled mentors and coaches for entrepreneurs would greatly enhance the ability of incubators to become more impactful. However the cost of skilled mentors and coaches is currently prohibitive; thus limiting the accessibility that entrepreneurs have to them.

- **Programmes to address the lack of self confidence amongst entrepreneurs**

Entrepreneurs should ideally be people with very strong self confidence. However, many people in South Africa lack the self confidence and faith in their own skills and ability to thrive as entrepreneurs. This is a product of South African history and culture which needs to be addressed through programmes or interventions.

## OTHER ASPECTS TO CONSIDER

- According to GEM research worldwide, necessity entrepreneurs employ, on average, less than one person whereas new opportunity entrepreneurs tend to employ between four and five people. The global norm is hence for funders of incubators to prefer assisting opportunity entrepreneurs who are more likely to create employment. □

### NOTES

1. High impact refers to entrepreneurs and businesses that have the highest potential for wealth and job creation.

In South Africa, when incubation services are offered to SMEs with a limited ability to pay, the government should get involved and find ways to subsidise these costs for eligible SMEs. However, if the incubation is being offered to high-potential, high-growth SMEs, these SMEs should have greater ability to pay, which, in turn, will improve the sustainability of the incubator.



How can we help you?







## ACCESS TO SKILLS



### OVERVIEW

Small to medium businesses in South Africa view availability and accessibility to skills as a key competitive advantage. Small businesses need these fundamental resources to build and grow their operations. In entrepreneurial environments, it is essential to attract talent and ensure that their potential is maximised, so that they can effectively respond to the complexities associated with operating a business. Entrepreneurs have the added challenge that they are not able to remunerate employees as competitively as large corporates are. Therefore, crafting a compelling employee value proposition becomes critical in the attraction and retention of talent.

### KEY POINTS OF DISCUSSION

#### • Attracting top talent into an entrepreneurial company

The key to attracting talent is to let them buy into the values, mission and promise of the business. This approach can sometimes be more effective than focusing solely on financial rewards and it ensures that existing and future employees walk the growth path with the entrepreneur. It also encourages a sense of responsibility towards the business, and discourages the temptation to move to other companies for bigger packages. It is therefore essential that entrepreneurial companies have an alignment between their values and the values of the individuals they are looking to attract.

When trying to build a scalable business, it is important for entrepreneurs to create a culture in which employees are able to live out their own dreams and aspirations. When this is done successfully, businesses can create a brand that gathers momentum through word of mouth as being an employer of choice. The greater the impact entrepreneurs can have on the people they engage with, the more likely these people will contribute to the success of the organisation. This will also show the levels of employee commitment as current staff members will encourage their friends to come and work for the company.

#### • Retention of top talent in an entrepreneurial company

It is inevitable that employees will leave at some point but in the meantime, the culture of an organisation is critical for retention. It should be noted that only talented employees, those who have a sense of belonging and add value need to be retained, and attrition is sometimes good. Attrition allows young organisations to try-and-test and to improve their ability to recruit new

employees with positive energy.

As many start-up businesses cannot afford to pay high salaries, retention of talent remains a challenge and a company's vision alone, however compelling, is not enough. Employees with the correct skills are highly sought-after and well remunerated. This challenges small businesses to become creative in sourcing and developing the skills they require.

Another challenge for small businesses is that due to capacity constraints, they often neglect to properly inform new hires about the company's culture and values, set key performance areas and review key performance areas on a regular basis. It is therefore important for entrepreneurs to be cognisant of the different methods of rewarding. Various models of financial incentives exist, which can be effective retention tools. For example, younger employees are concerned with growth and development opportunities which small businesses may not be able to provide, whereas older employees may worry more about health benefits and other family related aspects of their compensation.

It is also essential that entrepreneurs familiarise themselves with South African labour legislation, in order to better understand their rights as employers. This will empower entrepreneurs to manage their workforce better, especially with regard to non-performing employees. Retaining incapable employees can have a devastating impact on a small business, therefore following correct processes of dismissal is critical.

Entrepreneurs need to be mindful of the overall employee experience they create (or project to the outside world) for employees. That is what prospective, current, and ex-employees carry in their hearts and psyches;

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How can we help you?



It is a missed opportunity for entrepreneurs not to realise the value of leveraging complementary skills to grow their businesses. Allowing participation in the workplace and enabling employees to rotate between roles brings a fresh perspective to particular problems faced in the business.

and these perceptions are what create the 'brand-image' employers broadcast to their community. In turn, a company's reputation is ultimately what drives its propensity to attract an ongoing stream of talent.

- **Developing an entrepreneurial skills base – creativity, innovation, risk taking and opportunity finding**

It is important for companies to find a balance between allowing enough time for creativity and innovation, and delivering on the core requirements of the business. The 'scarcity mindset' or state of mind, where entrepreneurs become obsessed with the notion that 'resources are fixed', often prohibits creativity. The idea that a person can only succeed at the expense of somebody else's failure permeates many companies. This can be a big inhibitor for employees to understand the value of collaborating in order to create great products and services. The 'collaboration concept' is also lacking in entrepreneurs. It is a missed opportunity for entrepreneurs not to realise the value of leveraging complementary skills to grow their businesses. Allowing participation in

the workplace and enabling employees to rotate between roles brings a fresh perspective to particular problems faced in the business.

Mentoring and coaching for middle management staff within an entrepreneurial company is often lacking. Softer skills, such as independent problem solving, the ability to take initiative and action orientation are often not harnessed and sufficiently developed. These skills could contribute to the success of the organisation.

Many teachers or lecturers in entrepreneurial process. This results in their teaching-offering being of an extremely theoretical nature.

### RECOMMENDATIONS & INSIGHTS

- **Employee incentives that drive retention**

Attracting and retaining employees go hand-in-hand. When companies incentivise

employees to innovate and this innovation results in increased profits, entrepreneurs should reward them accordingly. The impact is that employees will have a direct line of sight to the company's bottom line which will further motivate them.

- **Flexibility in the structuring of salary packages**

To compensate for a small business's inability to offer comprehensive employee benefits, entrepreneurs should explore a cost-to-company approach. This allows employees to have the flexibility to structure their packages according to their needs and requirements. For example, younger and healthier employees may want to spend less of their earnings on benefits such as medical aid and pension and have higher take home salaries, whereas older employees may want to have a greater portion of their earnings allocated to retirement benefits.

- **Employee recognition programmes**

Recognition structures are an important tool to increase retention. When companies have defined programmes to reward certain behaviours, those behaviours will spread within the business. There is no substitute for challenging, quality work content which can be linked to a moral purpose, especially for knowledge workers. Small businesses have the latitude to positively impact working conditions and create environments that are more attractive than corporate environments. This has value that money cannot buy. Entrepreneurs can craft employee value propositions that are distinctive and effective in attracting and retaining talent.

- **Opportunity for broad functional exposure within small businesses**

Entrepreneurs should market the opportunities that exist in small businesses for younger employees. Entrepreneurial com-

panies provide an environment for younger talent to expedite their learning due to their exposure to different functional areas.

- **Ongoing scouting approach to find talent**

It is important for employers to constantly be on the lookout for talented employees, even though they may not always be actively hiring. This will ensure that entrepreneurs are continuously on the pulse of the labour market. They should also capitalise on their networks and use the referral system to incentivise staff in their search for talent.

- **Professionalism in the recruitment process**

The recruitment process must be done in a manner that conveys professionalism about the company. This will improve the reputation of the company and position it as an employer of first preference.

- **Requirement for specific labour laws to serve small businesses**

The labour laws in South Africa have to be more accommodating to small businesses. Currently, the labour laws are applied indiscriminately to large listed companies and small start-up entrepreneurial ventures. These laws are onerous and sometimes prohibitive to small businesses.

In summary, a balance between financial reward and culture-values is how small businesses can gain access to skills. Entrepreneurs need to look at attraction and retention holistically and remember that each individual is unique. In addition, a work environment needs to be created where employees can exchange ideas and where individual achievement is celebrated. Human capital is the most important aspect of a business and ultimately contributes more than anything else to the success of small ventures. □

To compensate for a small business's inability to offer comprehensive employee benefits, entrepreneurs should explore a cost-to-company approach. This allows employees to have the flexibility to structure their packages according to their needs and requirements.



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