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South African SMME Business Confidence Index Report: First Quarter 2006

Compiled by: Africagrowth Institute

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Africagrowth SMME Business Confidence Index Report

1. Introduction

This is the follow up report to the previous SMME survey conducted in the latter part of 2005. The same methodology was followed with a few additional members to the previous survey sample. Some respondents to the previous survey did not respond to the 2nd second survey which hampered the opinion difference in the sample spread. New respondents' opinion was however welcomed as we strive to increase our respondents' base.

2. Methodology

As in the initial survey, questionnaires were sent to senior managers or owners of the business entities that qualify to be categorized as SMEs. The same number of qualitative questions was asked to the respondents, whose answer will help determine whether a change in the business mood did in fact take place or not. As previously e-mails were sent to the previous respondents to the survey as well new ones in order to improve the national spread of the survey. The results indicated on the paragraphs below gives a picture of what changes did in fact take place.

3. Survey Results

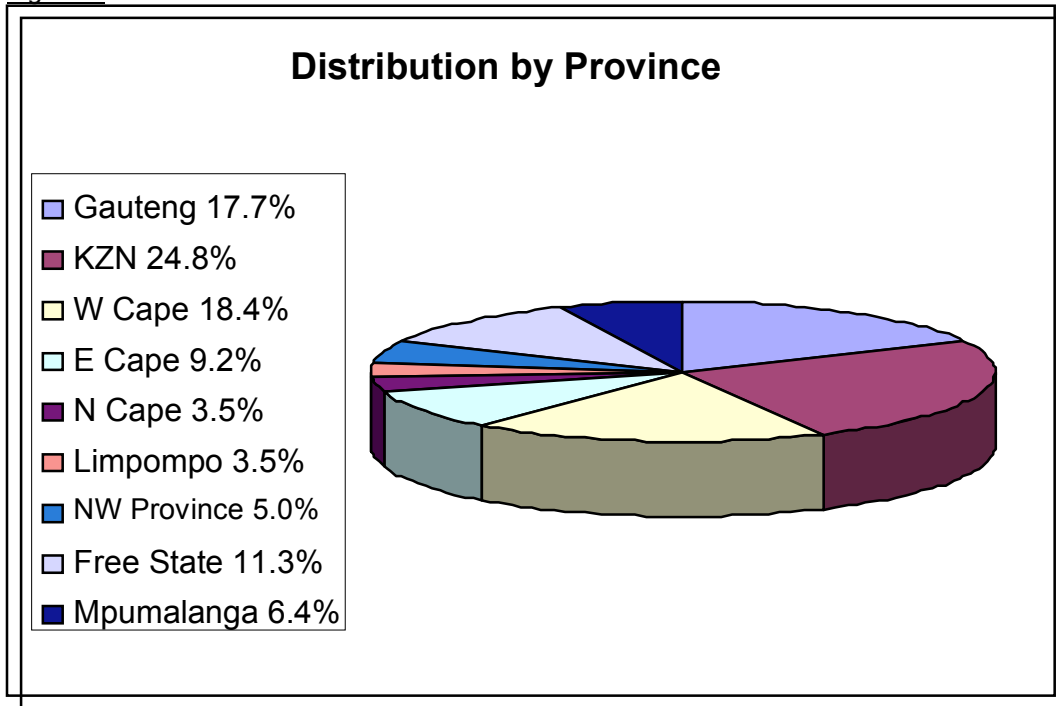
3.1 Demographics

This section of the report looks at the demographics of the 141 enterprises that completed and returned the questionnaires. Summaries are given in terms of the distribution of the responses by province, size of the organisation as determined by the number of people employed, and annual turnover and by economic sector.

3.1.1 Name of Province

There were 141 questionnaires that were received in total. The bulk off these came from KZN, Gauteng and the Western Cape. These were 24.8%, 17.7% and 18.4% respectively. The least number of responses were received from Northern Cape and the Limpompo provinces. We could attribute the small response from these provinces to the significantly low economic activity from these areas of the country.

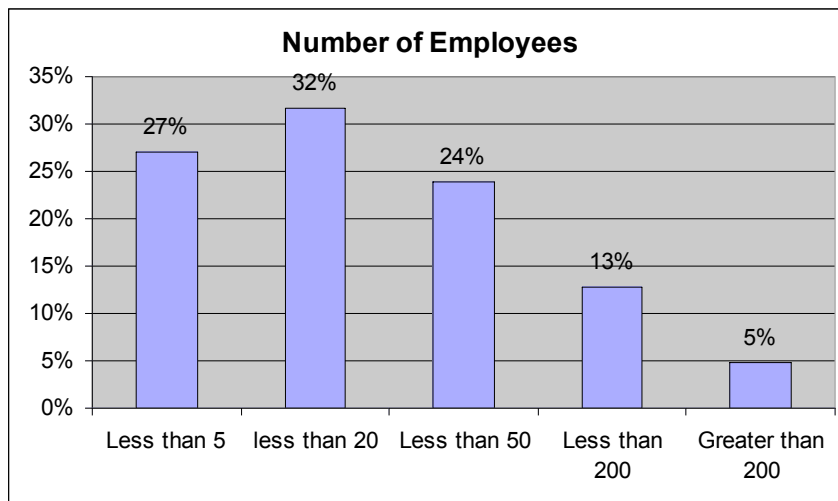
Figure 1.



3.1.2. Number of employees

The majority of the survey respondents at 31.7 % indicated that they employ more than 5 but less than 20 employees. This is followed closely at 27% by respondents that advise that they employ less than 5 employees at any given time. Only 4,8% of the respondents indicated that they employ more than 200 people. 23,8% of the respondents advised that they employ less than 50 employees whilst 12,7% advise that they employ less than 200. The employee breakdown is further illustrated by the diagram below.

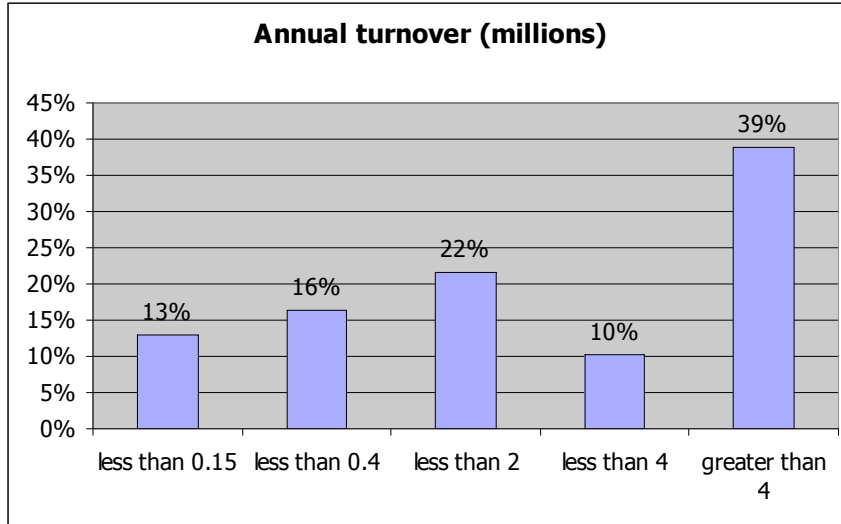
Figure 2.



3.1.3. Annual Turnover

Bulk of the reporting units at 39% reported an annual turnover of more that 4 million rands. This is followed at 22% by units earning less than R2m per annum. 16% reported earnings of less than R400 000,00 per annum whilst 13% reported earnings of less than R150 000,00 per annum.

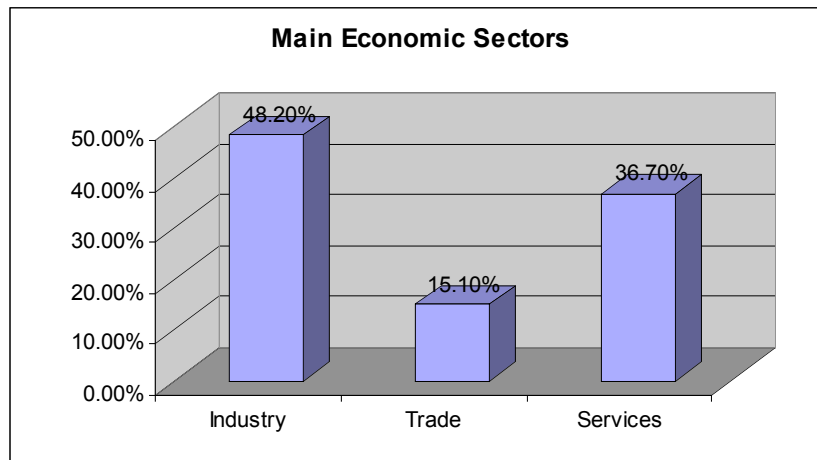
Figure 3.



3.1.4. Main Economic Sectors

The main economic sectors we conducted the survey on was Industry, Trade and Services. The majority of the respondents came from the Industry sector at 48.2%. This is followed fairly close by the Services sector at 36.7% whilst the Trade sector trails at 15.1%.

Figure 4.



3.1.4.1. Industry sub-sectors

There were in total 67 respondents from the Industry sector the bulk of which came from the manufacturing sub-sector at 85.1% of the respondents. The remainder is scattered amongst the Construction, Agriculture, Mining and quarrying, Electricity, gas and water sub-sectors.

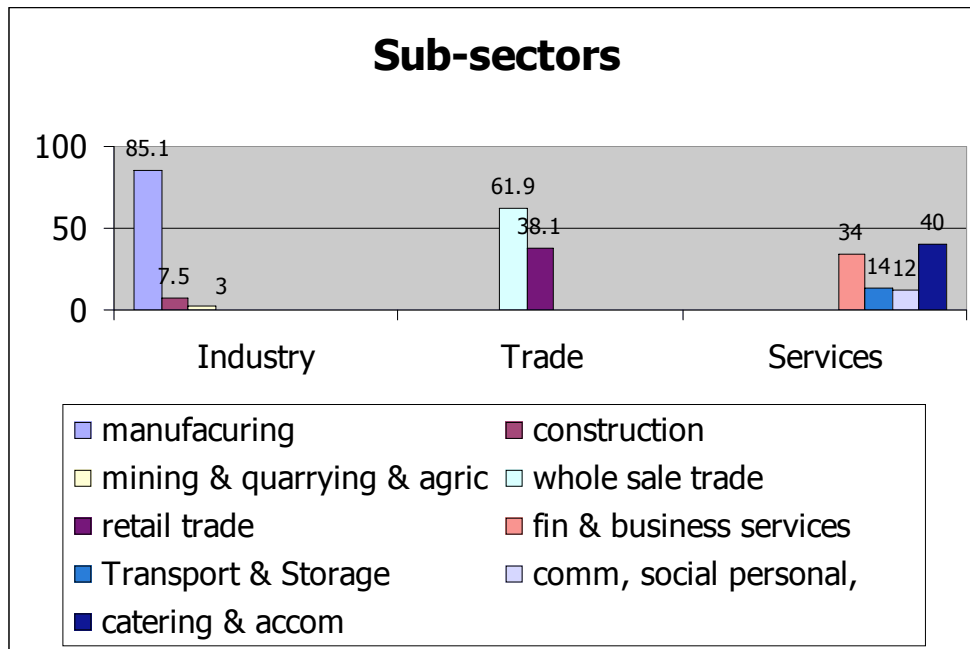
3.1.4.2. Trade sub-sectors

We received 21 survey responses from this sector accounting to about 15.1% of the total survey. The sector is further subdivided into Retail and Wholesale Trade each accounted to 38.1% and 61.9% respectively.

3.1.4.3. Services sub-sector

The Financial and Business Services sub sector together with the Catering and Accommodation sub-sector constitute 74% between the two of them. Transport Storage and Communication follows at 14% whilst Community Social and Personal trails at 12%.

Figure 5.



3.2. Present and Future Business Situation- Trade Sector

This section of the report discusses SME business perception of the present state of the economy and their outlook for the next 6 months. The responses presented represent the views of SMME engaged in trade related activities. The number of businesses that responded to this section of the questionnaire numbered 22 which was the same from the last quarter plus one.

3.2.1 Perception about present state of economy compared to the last 3 months - Trade

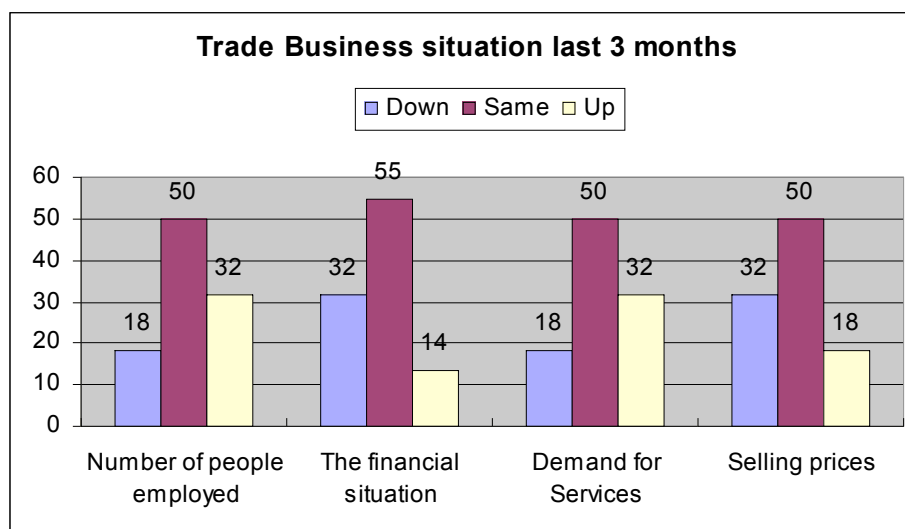
Employment Levels – About a third of the sample unit (31,8%) of the business managers and owners said their employment levels have gone up over the past three months. 50,0% indicated that they had not created any new positions whilst 18,2% stated that their employment levels have relatively gone down over this same period.

Financial situation - a third of the survey sample under this sector advised that their financial condition has gone down. More than half at 55% did not see any change at all in comparison to the last 3 months. 14% of the same sample unit advise that their financial lot has improved somewhat.

Demand for services – Half of the sample unit (50%) advice that there has been neither a decline nor increase in the demand for their products or services. 18% were less upbeat indicating that there actually has been a decline in the demand for their wares. A 3rd of the sample (32%) advised that there has been an increasing demand for products in their trading businesses.

Selling prices – 50% of the sample unit indicated that the selling prices have remained constant during this period. This figure complements the statistic above that the same number of respondents had felt that there was no change to the demand of their products. However 18% felt that the prices have gone down a bit. This could be insinuated by the strength of the Rand that hurts the export market which forms bulk of the business in this sector compounded with the competition from imports.

Figure 6. Trade Sector current business situation compared to the last 3 months.



3.2.2. Trade Future Business Outlook (for the next 6 months)

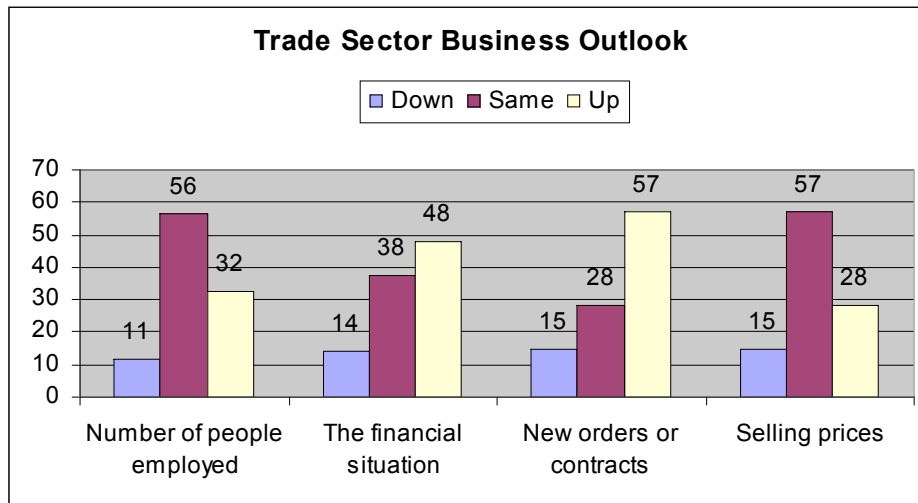
Employment Levels - More than half of the sample unit do not foresee any dramatic change in the number of people that will be employed in this sector. 14 percent felt that in fact is going to worsen whilst 32% felt there will be improvements. The general consensus here is that things will stay the same in the near future regarding up or down movements in new job creation.

Financial situation – The situation is somewhat upbeat with 48% of the respondents on this sector indicating that they think their financial lot will improve in the near future in comparison to the current situation. Less than half do not see any change on the foreseeable future. 14% felt that thing would worsen. This low figure gives hope of growth for business people in the trade sector.

New orders or Contracts – This sector remains upbeat towards acquiring new business and signing of new contract in the near future. A resounding 57% of the sample unit attested to this. A milder 28% were not so sure of this expected boom whilst 15% were prophesying doom.

Selling prices – A much needed boost in the new orders, 57% of the sample unit did not foresee any sharp increase in the selling prices. 28% envisaged a price increase in the selling of their wares whilst a meager 15 percent felt the prices would rather come down.

Figure 7. Trade Sector future Business Outlook: (next 6 months)



3.3. Present and Future Business Situation- Services Sector

In looking at the business situation with reference to the past three months, firms in the services sector indicated their opinion on a four-variable point scale; namely number of people employed, the financial situation, volume of demand and stock levels over a 9-month period (3 months before and 6 months into the future). Out of a total of 141 of the sample survey 49 respondents answered questions for this sector. This constitutes 34.8% of the total survey sample.

3.3.1 Services sector business perception compared to the last 3 months.

Employment Levels – The majority of the respondents at 67% did not see any change having taken place in the number of new jobs having been created presently compared to the last 3 months. A small number, 8% felt that there was in fact job shedding in this sector whilst 25% felt that there was some significant growth.

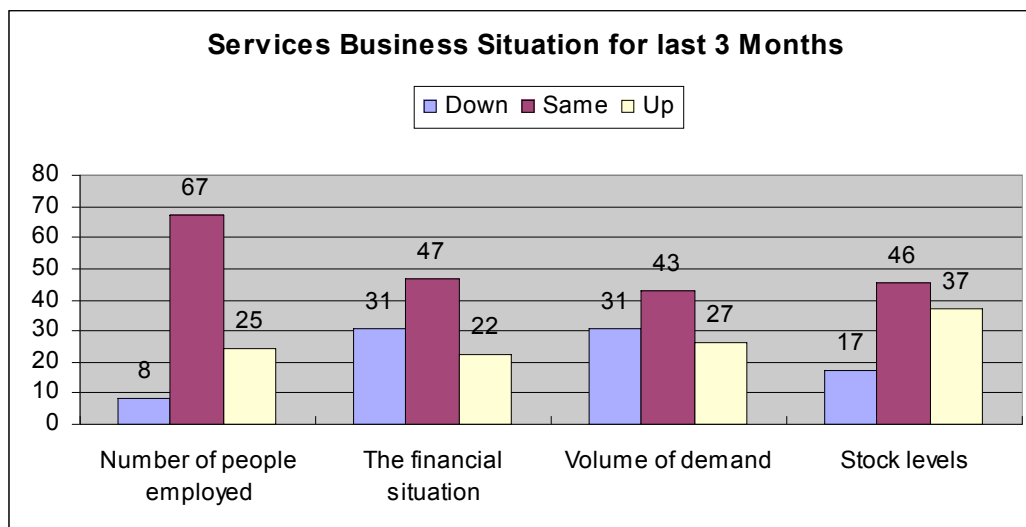
Financial situation – A little less than half of the respondents (47%) here felt that their financial situation has not in fact changed compared to the last 3 months. A third of the sample felt that this in fact has taken a decline whilst 22% were nominally upbeat with the performance of their respective business.

Volume of demand – With regards to the volume of demand, the sentiment is almost similar to the financial situation above. 43% of the sample unit do not see any change having taken place whilst 31% think that this has taken a marginal dive. About a third feel that things have improved in contrast to the last 3 months. The general consensus here is that sales have had no real impact on the profitability of businesses in this sector.

Stock levels - Again here the bulk of the respondents indicate that their stock levels have not changed by much. This is being contended to by 46% of the respondents. However 37% contradict this sentiment saying they have increased their stock levels in some anticipation of a higher demand in the near future.

Below is a graphical representation of the above assessment.

Figure 8. Services sector business assessment compared to the last 3 months:



3.3.2 Services Sector Future Business Outlook (for the next 6 months)

Employment Levels – The mood is strangely muted here with a whopping two thirds of the respondents not seeing any changes in their job creation drive. A quarter of the respondents have some hope that this grim situation will improve in time. A meager 8 percent felt that this situation will worsen in time. At least some positive forward leaps are expected here for the foreseeable future.

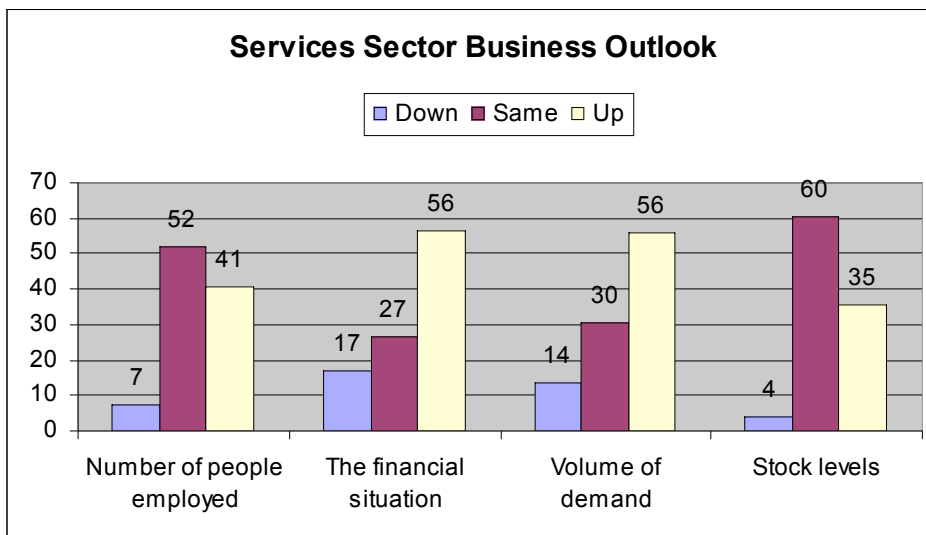
Financial situation – We again experience some optimism with a large number of the respondents at 56% expecting a boom via an increase in their financial situation. About a 3rd at 27% are not phased about any changes in their financial lot. The remaining balance at 17% felt that the situation will worsen instead of improving.

Volume of demand – The outlook here is still upbeat with a lot of the respondents at 56% expecting a growth in the demand for their services. Almost a third, at 30% does not anticipate any change whatsoever on the volumes of demand. A meager 14% have a gloomy outlook in the volume of demand in the services.

Stock levels – 60% of the respondents in this sector do not to anticipate any increase in their stock levels whilst 35% seem upbeat that they anticipate an increase in their stock levels. Only a meager 4% feel that their stock levels will go down. The general consensus being that services sector anticipate a mild change if any in the near future.

Below is a graphical representation of the above assessment.

Figure 9



3.4. Present and Future Business Situation- Industry Sector

3.4.1 Industry sector business perception compared to the last 3 months.

Employment Levels – A little over half (55%) of the reporting units advised that there has been neither growth nor decline in the number of people that they employ. 28% however indicated that there has been a steady growth in the number of people that they have given new jobs. Only 17% have felt that there has been some job shedding in their respective business enterprises.

Financial situation – 47% of the reporting units here indicated that their financial situation has neither gone up nor down. About a third at 31 percent says things are getting increasingly difficult

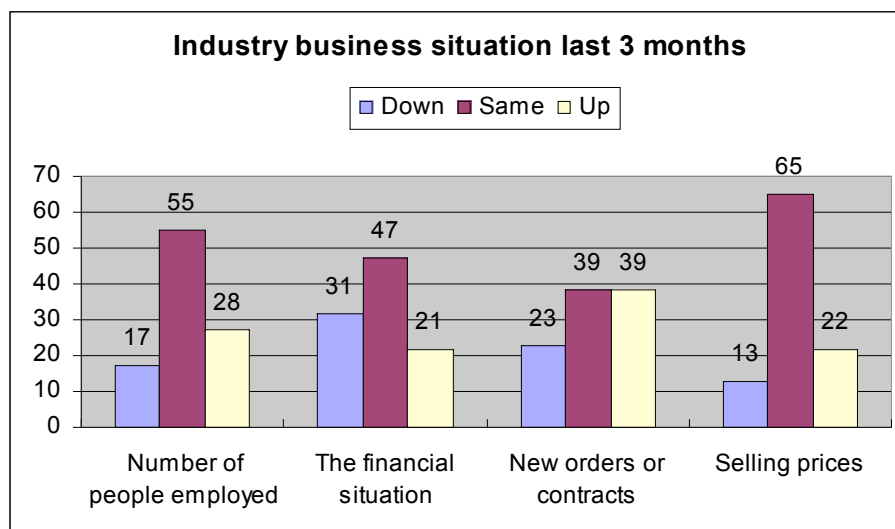
for them financially. Access to bank credit is their primary cause for concern as well as government regulations hampers their financial growth. This comes in the form of Tax, BEE requirements in the procurement procedures. Only 21% of the respondents felt that their fortunes were growing compared to the last 3 months.

New Orders or Contracts – Here again the mood is somber, 39% of the respondents advise that the demand for their services has been neither here nor there. A similar number indicate that there has been somewhat steady increase in the demand for their services or products. 23% of the industry respondents advised to the contrary and felt that the demand for their services or products has in actual fact declined.

Selling prices - The mood here is almost mooted with 65% of the responded advise that they have not changed their selling prices within the last 3 months. 13% indicated that they have seen a decrease in their selling prices. This could also be attributed to the low if not muted demand of the products or services. A significant percentage (22%) saw an actual increase in their selling prices.

Below is a graphical representation of the above assessment.

Figure B. Industry sector business assessment compared to the last 3 months



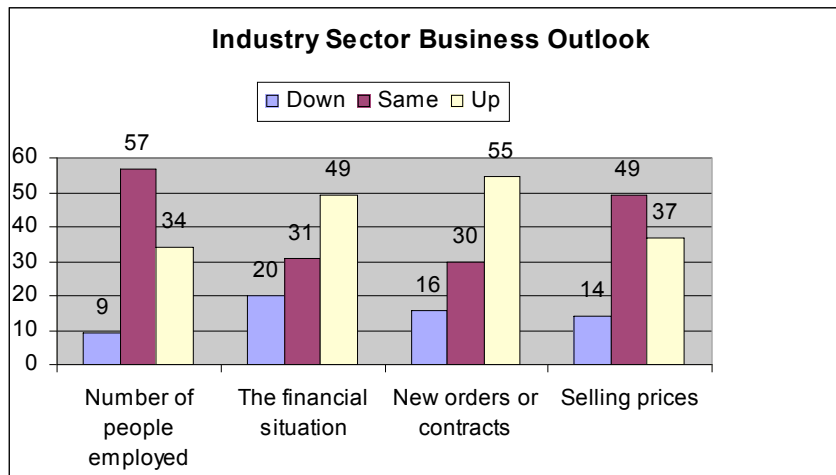
3.4.2 Industry Sector Future Business Outlook (for the next 6 months)

Employment Levels – 57% of the Industry sector survey sample do not foresee any major changes towards job creation. They felt that they will still operate with same manpower as they currently have. This is a sad state of affairs as to the government’s call for job creation by the private sector. A little over a third of this sector’s survey sample foresees an increase in selling prices in the near future. An insignificant number at 9% felt that prices will go down.

Financial situation – About half (49%) of the respondent here are generally upbeat that things will bode well for them financially in the near future. A further 31% are not that enthusiastic and therefore do not see their efforts being rewarded with higher profit margins. They feel that situation will play itself rather the same. A small number of respondents at 20% felt that things will go for the worst riding into the future. They in fact anticipate that their financial situation will actually drop going forward.

New Orders or Contracts – A little over half of the respondents at 55% are generally upbeat about the future outlook with respect to the demand for their products or services. Less than a third at 38% do not foresee any major or radical changes in the demand for services whilst only 16% of the survey sample felt that things will get worse.

Selling prices - Again here, 49% of the industrial sector survey sample do not anticipate any robust changes to the selling prices of their products. Even so, 37% think that there will be an increase in the selling prices going forward whilst a meager 14% think that prices should dramatically decrease.



Factors Limiting Business Success Analysis

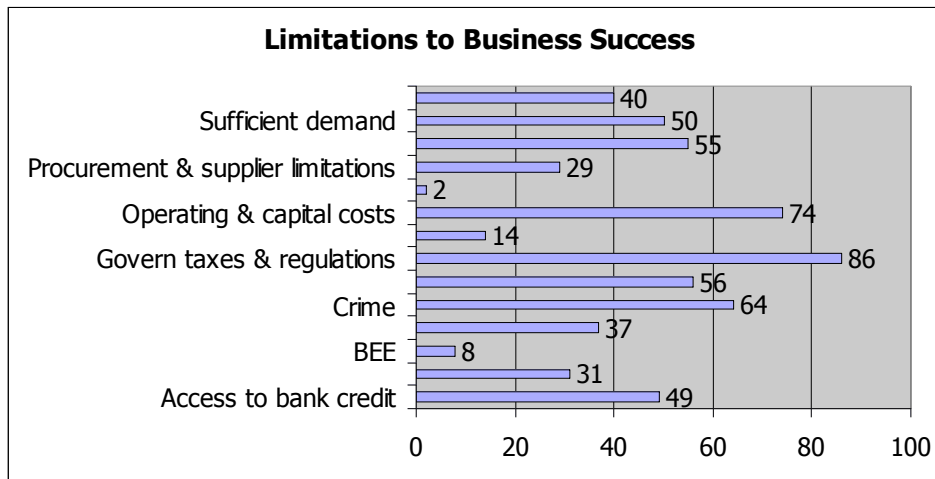
Government taxes and regulations were cited by most respondents as the most stumbling block to the growth and development of their businesses. This was cited by about 15% of the survey sample. Operating and capital Cost followed closely behind at 12,44%. This is the view equally shared by all 3 sectors of the economy.

Crime, Shortage of skilled labour and Insufficient demand for goods and services ranged from 8 to 11 percentage points as other factor that are of concerns to SMME. Shortage of skilled labour was more abundant in the Trade and Industry sectors than it was on the services sector. Half of the whole survey respondents cited access to bank credit as another factor worth looking into.

The current South African banking institutions are very wary of extending credit to SMEs because of the large failure rate of such entities. When they do open themselves up to this risk, they would require large amounts of collateral which is never there in 80% of the cases.

The employers also advised that BEE as the impact of HIV/AIDS does not necessarily affect them that much. This could be attributed to the very low numbers of employees that these entities employ.

Below is a schematic representation of the Business Limitations Affecting SMEs in South Africa.



3.5. The SMME Business Confidence Indices

3.5.1. Methodology

There are 2 common methods of constructing business confidence indexes, Net Balances and Diffusion Indexes. The Diffusion Indexes range from 0 to 100 whilst Net Balances range from -100 to 100. Both methods essentially have the same information content and move in the same direction when plotted over time. The SMME Index was constructed using the Diffusion Index method. The index is computed as:

$$DI = 100(U + S/2)$$

DI = Diffusion Index

U = Fraction of (Up) responses to questions in the survey

S = Fraction of (Same) responses to questions in the survey

Though the reporting units (firms) within the sample come from a homogenous group of SMMEs there are nonetheless differences in the sizes. The difference in sizes is captured by the number of employees in each firm. In this regard responses from larger firms would carry more weight than that of smaller firms. A size weight is therefore computed and used to weight the responses.

$$DI_w = \sum^s (DI \times w_s)$$

DI_w = Weighted Diffusion Index

w_s = Size weights based on the number of employees in each firm, thus the larger the number of employees in a particular firm the larger the weight for that firm.

A composite confidence indicator which measures the general assessment of present economic conditions and future expectations is also computed. For each question and industry an index is computed for both the present and future business situation. For instance for the Present business situation compared to the last 3 months the indices are computed as follows:

Industrial Confidence Index:

1. Q3a1: The number of people employed (DI_{a1})
2. Q3a2: Financial Situation (DI_{a2})
3. Q3a3: New Orders or contracts (DI_{a3})
4. Q3a4: Selling prices (DI_{a4})

Q3a1-Q3a4 are questions relating to Section 3a in the survey
 (DI_{a1}) - (DI_{a4}) are indices for each question

The Industrial Confidence Index (ICI) is given as:

$$ICI = (DI_{a1} + DI_{a2} + DI_{a3} + DI_{a4}) / 4$$

Trade Confidence Index:

1. Q3b1: The number of people employed (DI_{b1})
2. Q3b2: Financial Situation (DI_{b2})
3. Q3b3: New Orders or contracts (DI_{b3})
4. Q3b4: Selling prices (DI_{b4})

Q3b1-Q3b4 are questions relating to Section 3b in the survey
 (DI_{b1}) - (DI_{b4}) are indices for each question

The Trade Confidence Index (TCI) is given as:

$$TCI = (DI_{bc1} + DI_{b2} + DI_{b3} + DI_{b4}) / 4$$

Services Confidence Index

1. Q3c1: The number of people employed (DI_{c1})
2. Q3c2: Financial Situation (DI_{c2})
3. Q3c3: New Orders or contracts (DI_{c3})
4. Q3c4: Selling prices (DI_{c4})

Q3c1-Q3c4 are questions relating to Section 3c in the survey
 (DI_{c1}) - (DI_{c4}) are indices for each question

The Services Confidence Index (SCI) =

$$SCI = (DI_{c1} + DI_{c2} + DI_{c3} + DI_{c4}) / 4$$

The overall index for the present business situation compared to the last 3 months (OIp) is given as
 $OIp = (ICI + TCI + SCI) / 3$

The same methodology as above is followed for the future outlook questions to obtain the overall index for the future business outlook in the next 6 months (*Olf*). The Overall SMME Confidence Index (*OSI*) is the average of the present and future indices.

List of Tables (2nd Survey)

Table 1 Question Specific Business Confidence Indices by Sector

PRESENT					
	<u>Industry</u>		<u>Trade</u>		<u>Services</u>
q3a1	56.72	q3b1	59.52	q3c1	55.88
q3a2	47.01	q3b2	15.91	q3c2	44.12
q3a3	60.45	q3b3	59.52	q3c3	46.08
q3a4	55.97	q3b4	45.24	q3c4	41.18
Index (present)	55.04		45.05		46.81
Overall Present Condition Index					
48.97					
FUTURE					
	<u>Industry</u>		<u>Trade</u>		<u>Services</u>
q4a1	59.96	q4b1	73.49	q4c1	60.74
q4a2	61.73	q4b2	64.17	q4c2	45.48
q4a3	64.25	q4b3	75.01	q4c3	49.64
q4a4	58.37	q4b4	64.29	q4c4	34.57
Index (future)	61.08		69.24		47.6
Overall Future Outlook Index					
59.31					
Overall Index (present and future)					
54.14					
	<u>Industry</u>		<u>Trade</u>		<u>Services</u>
%change present to future	10.97%		53.70%		1.69%
Overall Index %change present to future	21.12%				

q3a1-q3a4 are questions relating to Section 3a in the survey q3b1-q3b4 are questions relating to Section 3b in the survey q3c1-q3c4 are questions relating to Section 3c in the survey q4a1-q4a4 are questions relating to Section 4a in the survey q4b1-q4b4 are questions relating to Section 4b in the survey q4c1-q4c4 are questions relating to Section 4c in the survey

Table 2 Business Confidence Indices for Present and Past Outlooks by Sector

Industry Confidence Index Present	Industry Confidence Index Future	Services Confidence Index Present	Services Confidence Index Future	Trade Confidence Index Present	Trade Confidence Index Future
55.04	61.08	46.81	47.60	45.05	69.24

Table 3 Overall Business Confidence Indices

Industry Index	58.06
Services Index	47.20
Trade Index	57.15

Present conditions Index	48.97
Future outlook Index	59.31
Overall Index	54.14