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## **Transforming small South-African businesses to medium and large enterprises through entrepreneurship development**

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### **Abstract**

In view of the poor performance of SMEs in South Africa, particularly start-ups, and considering that current government interventions and initiatives do not seem to be producing the desired results, this research explored alternative methods of stimulating and promoting SME development. An explanatory qualitative study was conducted by interviewing four opportunity (high-impact) entrepreneurs using semi-structured open-ended questionnaires. The main finding was that current SME policies and programs are focused largely on stimulating behavioural entrepreneurship and entrepreneurial business activity, with a bias towards new venture creation and start-up activity as the barometer. This resulted in a skewed focus towards the stimulation of necessity entrepreneurship and promotion of start-ups which are prone to high failure and tantamount to self-employment. The primary conclusion was that start-ups fail, not because they are not viable ventures, but because the owners do not understand the complexity of navigating a business from inception, through its growth and expansion stages. Thus, it is recommended that a new ecosystem of entrepreneurship coined '*enterpriseneurship*', be established, whose objective is to support existing high-impact SMEs to withstand the start-up pains and migrate successfully to the growth and development stages.

**Keywords:** entrepreneurship, SMEs, enterprise development

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### **Introduction**

While small and medium enterprises (SMEs) are viewed as the engines of economic growth and job creation in both developed and developing countries across the world, this has not been equally true in South Africa. In Organisation for Economic Co-operation and Development (OECD) economies, SMEs make up more than 95% of enterprises and contribute to between 60 and 70% of the employment opportunities (Muriithi, 2017) <sup>[12]</sup>. Although SMEs make up 90 percent of formal business enterprises in South Africa, they only contribute about 39% towards the Gross Domestic Product (GDP) and provide employment to about 56% of the formal labour force (Stats SA, Q1: 2019) <sup>[24]</sup>. Entrepreneurship and enterprise development are not achieving the requisite results, despite huge investment by the South African government in SME development and job creation. It is hardly contestable that governmental support is vital for the development and promotion of a thriving SME sector. The South African government's commitment to stimulate entrepreneurship and to develop the SME sector is evident from numerous interventions – legislation, policy, programs, incentive schemes and the huge investment in institutional infrastructure. However, given the massive resources which the South African government commits towards the SME sector, it is evident that the apparent lack of impact is happening despite government's efforts and initiatives. The South African government spends about R2 billion every year (Chinomona & Maziriri, 2015) <sup>[5]</sup> to support start-ups/new ventures and their related activities across the country.

Valliere and Peterson (2009) <sup>[22]</sup> note that it is generally accepted that galvanising SMEs is one of the ways South Africa could use to resolve its triple challenges of unemployment, poverty and

inequality. Questions have been asked and remain unanswered, on whether government interventions and initiatives to create jobs, alleviate poverty and reduce inequality through current SME development policies and programs focused largely on stimulating entrepreneurship and entrepreneurial activity – particularly new venture creation and start-ups, are producing desired results. The poor performance of start-ups in South Africa indicates that there is a need for alternative policies aimed at supporting and promoting SMEs, not only during their difficult birthing stage, but also regarding the development of management skills that are necessary to overcome failure and promote their sustainability. In view of the above, this paper will explore alternative methods of stimulating and promoting SME development.

### **Literature Review**

Although governments generally employ measures that support the development of entrepreneurial activities, particularly start-ups, they inadvertently neglect the sustainability challenges faced by SMEs. According to Smorfitt (2008) <sup>[20]</sup>, "*Government interventions are aimed at improving the start-up rate rather than strengthening existing SMEs.*" There is too much emphasis on providing finance to start-ups, compared to solving the sustainability challenges faced by newly established SMEs (Caporali, 2006).

The Global Enterprise Monitor (GEM 2014) <sup>[10]</sup> lists some of the major constraints to SME growth and development in South Africa as an insufficiently educated workforce, stifling bureaucracy in government, onerous labour laws, the low efficiency of the labour force and corruption starting at the

highest levels of government, together with high levels of crime. Olawale and Garwe (2010) [14] outline the universal constraints which continue to stifle the growth of South Africa's SMEs through unintended, yet restrictive government policies, whose characteristics include inefficient labour markets, indiscriminate tax laws imposing a disproportionately heavy burden on SMEs, arduous and inefficient bureaucratic red tape, fragmented policies, low level of competition and a high early failure rate. Other constraints inhibiting South African entrepreneurs include the costs and sometimes the unintended burden of legal and statutory compliance requirements by SMEs, inability to access a slice of the procurement pie, access to markets and customers, funding, revenue generation, and talent discovery and skills development (PWC, 2015) [17].

**The challenges of unsustainable SME development in South Africa include inter-alia**

▪ **Low entrepreneurial activity**

South Africa's rate of entrepreneurial activity is a mere quarter of that seen in other African countries. South Africa has a dismal Total Early-Stage Entrepreneurial Activity. "Only 7% of the adult population in South Africa are engaged in entrepreneurial activity, and according to Global Entrepreneurship Monitor (GEM, 2014) [17], a mere 2.7% already own or manage an established business" (Von Broembsen, et al., n.d.; Swanepoel, et al., n.d.; Chinomona & Maziriri, 2015) [23, 5].

▪ **High start-up and SME failure rate**

Less than 50% of start-ups survive beyond their first five years and only a fraction become high-growth firms that create jobs in South Africa (Maas & Herrington, 2007) [11]. The attrition rate of SMEs in South Africa poses an economic challenge because most of them are too small to create jobs.

**Low transition rate of enterprises from small-to-medium and medium-to-large**

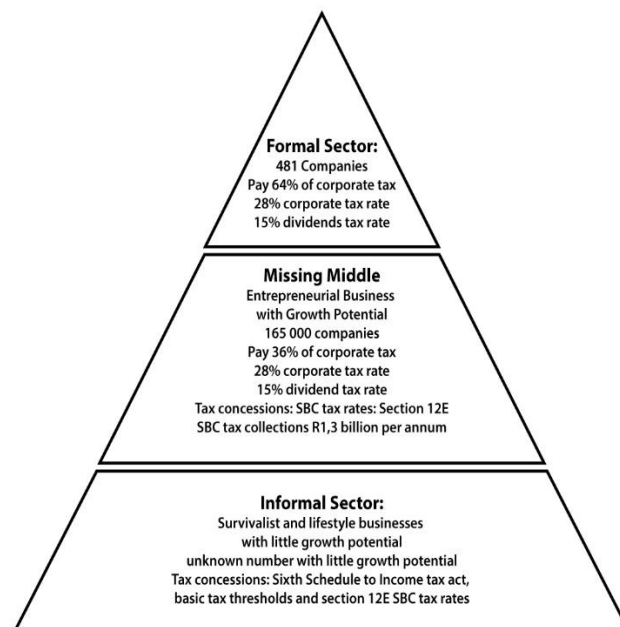
South African SMEs also face a broad spectrum of constraints that they are unable to manage, even in economies that provide an enabling environment, including cumbersome regulatory requirements and inhibiting legal frameworks, access to markets and acquisition of customers, funding or rental of premises - at affordable rates, development of management skills and expertise, access to technology, the quality (or lack thereof) of enabling infrastructure and tax administration which is not optimised for SMEs.

Other constraints unique to South Africa include issues that are linked to the history of the country, since for decades, the South African black majority population was deprived of quality education and opportunities to participate in the formal economy. The education system restricted opportunities to acquire technical and professional skills by black people and there was a vacuum in the provision of entrepreneurial education, particularly to black people.

Transforming the South African economy and creating sustainable employment, reducing in-equality and alleviating poverty as proposed in the National Development Plan (NDP, 2013) [13], demands that GDP should increase by 2.7 times in real terms, requiring consistent average annual growth of 5.4% over the period up to 2030. The National Planning Commission (NPC, 2016) estimates that this requires total employment to almost

double to 24 million by 2030. South Africa's unemployment rate increased to 29% in the second quarter of 2019 and averaged a worrisome 25.71% between 2000 and 2019, reaching an all-time high of 31.20% in the first quarter of 2003. South Africa's economic growth is presently subdued and under-performing. GDP growth forecast for 2019 have been revised to 1.5%, from an estimated 1.7% at the time of the National Treasury's 2018 Medium Term Budget Policy Statement (MTBPS).

Despite extensively documented government interventions where vast amounts of resources have been channelled towards creating and growing SMEs, the formal business sector in South Africa has hardly changed since 1994 (Maas & Herrington, 2007) [11]. Some economists in developing countries have coined the term 'missing middle', which implies that many small firms and a few large firms produce the bulk of value added and contribute towards GDP. This forms part of a wider cluster of interrelated characteristics, including a large informal sector and regulatory barriers to entry into the formal sector, that have often been explained with reference to the 'grabbing hand' associated with bureaucratic inefficiency and corruption (Friedman et al. 2000; Djankov et al. 2002) [9, 6]. The missing middle phenomenon suggests an economy with concentrations of small and large firms, but with no intermediate-sized firms. Another possibility is that the level of the output cut-off used to exempt firms from taxation is so low that only a small number of firms take advantage of it, generating a size distribution of firms with intermediate- and large-sized firms and a few much smaller untaxed firms, representing an 'isolated bottom' of the size distribution. Figure 1 depicts the phenomenon of the 'missing middle'.

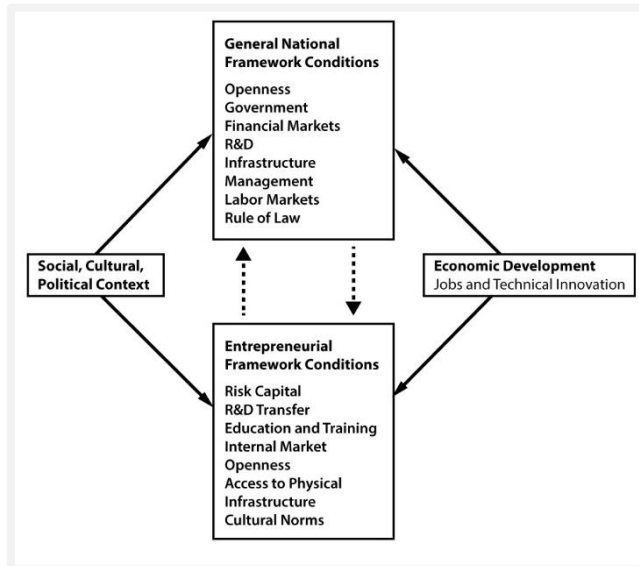


Source: Treasury SA, 2016

Fig 1: The Missing Middle

The concept of the 1<sup>st</sup> and 2<sup>nd</sup> economy is supported by the GEM's conceptual model of General National Framework Conditions and Entrepreneurial Framework Conditions. As depicted in Figure 2, the GEM's conceptual model explains that policies in less developed countries should focus on

strengthening General National Framework Conditions, whereas in developed economies policies should focus on strengthening the Entrepreneurial Framework Conditions.



Source: Acus, 2008

Fig 2: Global Entrepreneurship Monitor (GEM) Conceptual Model

The fact that South Africa exhibits characteristics of both General National Framework Conditions (2<sup>nd</sup> economy) and Entrepreneurial Framework Conditions (1<sup>st</sup> economy) perpetuates the inequality gap instead of narrowing it. Ideally, as a developing country, South Africa should focus on reducing the number of self-employed people and strengthening the small and medium sized sector. This is a profound policy position in light of the question whether all SME business owners are entrepreneurial. Those with less education in developing countries end up in ‘necessity’ entrepreneurship, hence a commitment to education and training is important.

For budding entrepreneurs, the decision to start a business hinges on additional Entrepreneurial Framework Conditions. Inadvertently, this also creates scope for the creation of markets, i.e., as the income per capita increases, the emergence of new technologies and opportunities for economies of scale attracts larger and more established firms to assist with meeting this emergent demand, and inadvertently plays a vital role in becoming enablers for the development of the economy. As household and disposable income increases, more people go into business provided the conditions are conducive for the exploitation of opportunities. Simultaneously, the number of new businesses, particularly ‘necessity’ businesses decrease, as more people secure stable employment. The fact that South Africa consists of businesses across different economic levels is an impediment to the development of SMEs. On the one hand, South Africa has the prevalence of poorly educated, low-skilled mostly the black majority, who are reliant on informal SMEs and small-scale subsistence activities, and on the other hand, the established white businesses boast superior education and advanced skills which enables them to engage in ‘opportunity’ motivated entrepreneurship.

In view of the poor performance of start-ups in South Africa and given that current government interventions aimed at SME

development and job creation through targeted policies and programs seem to be failing, this study explored alternative methods of promoting sustainable enterprise development not only during the difficult start-up stage of SMEs, but also the management skills required to overcome failure and promote their sustainability during their transition from small-to-medium and from medium-to-large enterprises. Departing from the premise that not all SME business owners are entrepreneurs and engage in entrepreneurship or entrepreneurial business activities, the study attempted to recommend ways by which the activities of non-entrepreneurial business owners and non-entrepreneurial business activities could be isolated, understood, promoted and supported, in order to counter the current high failure rate of start-ups by becoming more effective catalysts for job creation, poverty alleviation, reduction of inequality and inclusive economic development in South Africa.

### Research Methodology

A qualitative study was conducted by interviewing four opportunity (high-impact) entrepreneurs using semi-structured open-ended questionnaire. A qualitative approach was adopted since the aim was to explore issues about the problem on about which very little is known (Domegan & Fleming, 2007, p. 24)<sup>[7]</sup>. Furthermore, the purposes of the study is to understand phenomena, and not to extrapolate the results to the representative population, non-probability and non-random sampling methods were used. A combination of purposive and referral sampling techniques was used to select participants who are well informed about the topic (Saunders & Lewis, 2012)<sup>[18]</sup>. The sample was high-impact business owners who have successfully managed their enterprises for more than five (5) years. Six (6) cases were sampled originally, but the researcher stopped at four (4) after reaching saturation. By the fourth interview, the researcher felt that all the research questions had been answered and confirmed. Maybe this happened so soon because of the richness of the cases selected.

Two of the cases were original SMEs who started their businesses using their own ideas and the other two were ‘*exopreneurial*’ SMEs who started their businesses using franchising models. Within each case, two interviews were conducted with the respective business owners. In addition to the direct personal interviews, the researcher recorded relevant archival data from business records and made personal observations.

A semi-structured interview guide was specifically designed for the study. Open-ended, neutral, singular and clear questions were used for the interviews, such that participants’ responses were not predetermined. Although the wording of the questions was predetermined, the sequence of the questions was determined by the conversational flow. However, following Easterby-Smith, *et al.*’s (2004)<sup>[8]</sup> recommendations, the researcher aimed to cover all the themes during the interviews. This approach enabled the collection of data systematically and assisted the researcher to cover all issues of interest (Patton, 2002)<sup>[15]</sup>. The researcher explained the purpose of the study clearly and dealt in detail with the ethical aspects. Participants were sent a copy of the interview guide upfront via email to ensure that they familiarise themselves with the content to be covered.

The researcher personally conducted each of the four interviews. Although each interview was audio recorded, the researcher took detailed written notes. The data was transcribed, after which

thematic content analysis was conducted to identify the emerging themes. The results were then analysed and interpreted to arrive at key findings and conclusions.

### Research Findings

It was ascertained that the support government offers for the development of SMEs in South Africa is ineffective, partly because it focuses on creating an enabling business environment for the entrepreneurial spirit to thrive, instead of imparting the critical success factors necessary for the sustainability and growth of existing SMEs, including human capital skills. Furthermore, due to the lack of a good education system capable of instilling creativity and critical thinking, most South African entrepreneurs take risks and commit financial and physical resources to establish business ventures out of ‘necessity,’ without the underlying idealistic grounding. It is unrealistic to expect the pursuit and promotion of ‘idealistic’ or ‘behavioural entrepreneurship’ within an environment in which the target market of government’s SME policies are predisposed to necessity and survivalist tendencies, whose education system doesn’t cultivate critical thinking and creativity and grow up devoid of hope, with little or no stimulating interactions and experiences with successful role models.

Acs and Preston (1997) observed that behavioural entrepreneurship focusing on the significance of attitudes or intentions may be appropriate for high-income developed countries with established Entrepreneurial Framework Conditions. Entrepreneurial Framework Conditions encourage start-ups. On the contrary, functional and occupational entrepreneurship focusing on the significance of the activity may be required for developing economies such as South Africa with prevalent General National Framework Conditions, which dictate the need to strengthen the small and medium sized sectors first, as the first step toward development. The most important consideration in this regard is that policies for less developed countries are focused on the firm and not the individuals. Key support factors in this regard include financial assistance, management assistance, training and reducing regulatory burdens.

The findings also reveal that South Africa’s current SME development policies and programs may be ineffective because they are biased towards the development and support of start-ups and ‘necessity’ entrepreneurs, who are prone to high failure. Furthermore, it became apparent that a less developed country like South Africa would be better off if its SME development policies and programs strengthened existing SMEs. South African’s SMEs should also not concern themselves with Schumpeter’s (1934) disruptive entrepreneurship, which mainly serves the purpose of creating market disequilibrium from its original equilibrium position by generating innovations, when jobs are required.

Emerging from the findings, it was concluded that there is a need for a new ecosystem of entrepreneurship, aptly coined ‘enterpriseneurship’<sup>[1]</sup>, whose objective is to support existing high-impact entrepreneurs who have already gone some way towards building sustainable enterprises, not only because the

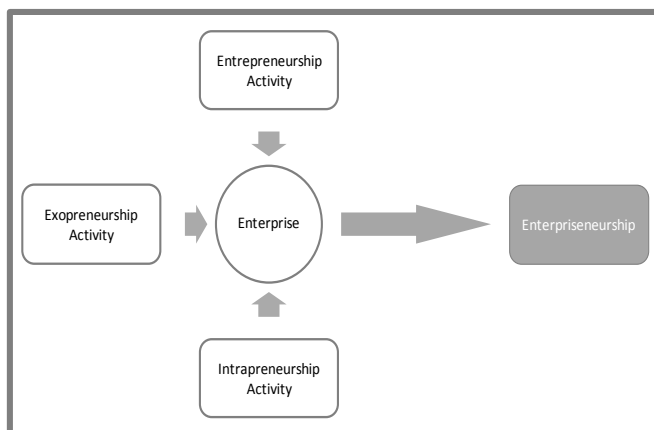
chances of success are higher, but mainly because the chances of failure are mitigated. The thrust of the ‘*enterpriseneurship model*’ is to strengthen existing high-impact SMEs by documenting and standardizing their systems and processes with a view to scale them up and replicate their already successful businesses. The introduction of ‘*enterpriseneurship*’ is informed by the key findings of the study to the effect that the promotion of start-ups as the main method of stimulating SME development is a treacherous activity fraught with risks and high failure rate. The argument that not all SME business owners are entrepreneurs and always engage in entrepreneurship and entrepreneurial business activity is central to introduction of the concept of ‘*enterpriseneurship*.’ While Schumpeter’s (1934) theory posits entrepreneurs as innovators who are in the business of doing something different, be it through the identification of new products, processes or markets, the ‘*enterpriseneurs*’ conceived in the study follow Drucker’s concept of ‘*non-entrepreneurial SME business owners*’ who take calculated risks by engaging in ‘*entrepreneurial business activity*’ merely for profit making, or as an escape from unemployment. The idea to encourage the engagement of ‘*non-entrepreneurial SME business owners*’ in the scaled up or replicated ‘*entrepreneurial business activity*’ of existing high-impact entrepreneurs through *enterpriseneurship* is concomitant with the view that entrepreneurship can be manifested even in the absence of an entrepreneur.

The view that Schumpeter (1934) which was among the first to distinguish entrepreneurship and the entrepreneurs from business owners and managers, supports the emergent “*enterpriseneurship*” ecosystem. Previous researchers (Ahmad & Seymour, 2008) also suggests that entrepreneurship and the entrepreneur are distinct from business owners and managers, describing entrepreneurs as individuals whose function is to carry out new combinations of means of production characterized by innovative strategic practices. Although it is generally agreed in the literature that where there are entrepreneurs there will always be entrepreneurial activity (Ahmad & Seymour, 2008), the reverse is not true, namely, where there is entrepreneurial activity there will always be an entrepreneur. This distinction is very important because intrapreneurial individuals within businesses may also demonstrate entrepreneurship without necessarily having a stake in the company. Entrepreneurs, and what differentiates them from other business owners, are in the business of doing something different, whether that is through identifying new products, processes or markets which increase the likelihood of success, employment, productivity and efficiency of their company. Holmes and Schmitz, (1990) state that people with greater entrepreneurial abilities specialise in the development of new products (in response to exogenous technological breakthroughs), for example, by starting a new business, but can transfer that business to another person at later stages. These researcher’s idea that people with greater entrepreneurial abilities can transfer their business to another person at later stages supports the involvement of ‘*non-entrepreneurial SME business owners*’ in ‘*entrepreneurial business activity*’. It is this business transfer which represents the concept of ‘*enterpriseneurship*’ introduced in this study.

*owners*’, aptly coined *enterpriseneur* who engage in ‘*entrepreneurial business activity*’ or *enterpriseneurial activity*. In the context of the study, *enterpriseneurship* is the phenomenon associated with *enterpriseneurial activity*.

<sup>1</sup> The term ‘*enterpriseneurship*’ is derived from the noun ‘*enterprise*’, which means ‘*a business or company*’ and adjective ‘*enterprising*’, which means ‘*having or showing initiative and resourcefulness*’. The concept of ‘*enterpriseneurship*’ describes the role of ‘*non-entrepreneurial SME business*

Despite the clarity that not all SME business owners are entrepreneurial and always engage in entrepreneurship and entrepreneurial business activity, the apparent lumping of entrepreneurs and non-entrepreneurial SME business owners by SME support policies and programs of the South African government, seeks to distinguish the role of ‘non-entrepreneurial SME business owners’ who engage in ‘entrepreneurial business activity’. Therefore, ‘*enterpriseneurship*’ seeks to promote high-impact entrepreneurial business activity without the risks usually associated with idealistic opportunity entrepreneurship. This objective is achieved by deliberately targeting the scaling up and replication of existing high-impact entrepreneurial SMEs whose business models, products, systems and processes are tried and tested, thus minimizing the failure rate of risky start-up entrepreneurial business activity. The fact that ‘*enterpriseneurship*’ seeks to minimize the failure rate of risky start-up entrepreneurial business activity without compromising the snowballing effects of high-impact ‘opportunity’ entrepreneurial business activity, is the main attraction of the emergent ‘*enterpriseneurship*’ ecosystem. *Enterpriseneurship* is the sum-total of an interplay of entrepreneurial, intrapreneurial and *exopreneurial* factors, whose activities manifest themselves within the enterprise as schematically shown in *Figure 3*.



Source: Researcher’s Proposition

Fig 3: *Enterpriseneurship*

The implementation of ‘*enterpriseneurship*’ is likely to counter the current high failure rate of start-ups by fostering the creation of sustainable business enterprises, thus facilitating the creation of sustainable jobs, reduction of poverty and reduction of inequality through inclusive economic growth. The ‘*enterpriseneurship*’ ecosystem promises to yield dual benefits as it will offer support for necessity non-entrepreneurial SME owners on the one hand and assist high-impact entrepreneurs to grow their medium-sized businesses on the other hand. High-impact businesses generally produce bigger, better and faster results. For instance, to create 1 000 jobs, it is estimated that seven hundred and fifty-one (751) new micro-enterprises, thirty-seven (37) new SMEs or five (5) SMEs that grow into large enterprise should be supported (PWC, 2015, p. 66).

## Conclusions

A recurring theme throughout the study was that current SME development models in South Africa are geared towards supporting start-ups, and fail to give adequate support to enterprises run by ‘opportunity’ entrepreneurs, particularly existing SMEs established and managed by entrepreneurs who have proven themselves under difficult circumstances, often without much support, making it difficult for them to either scale or replicate their businesses. The key conclusions from the study are summarised hereunder:

- The lack of impact in sustainable enterprise development in South Africa may be because current SME policies and programs are focused largely on stimulating entrepreneurship and entrepreneurial business activity, with a bias towards new venture creation, necessity entrepreneurs and the development and support of start-ups which are prone to high failure and tantamount to self-employment.
- Not all business owners are entrepreneurs and not all businesses are involved in entrepreneurial business activities. This conclusion focuses attention on the peculiar shortcomings of non-entrepreneurial business owners and managers venturing into business, particularly necessity start-ups.
- Business start-ups fail, not because their ventures are not viable, but because they do not understand the complexity of navigating a business from inception, through its growth and expansion. The poor performance of start-ups in South Africa indicates that there is a need for alternative policies aimed at supporting and promoting SMEs – not only during their difficult birthing stage, but also about the management skills necessary to promote their sustainability.

## Recommendations

As much as risk aversion should be balanced with the need to support the snowballing effect of high-impact entrepreneurship, a high start-up failure rate as is the case in South Africa is costly and should be mitigated by prudent and sustainable enterprise development policies. Thus there is need for a new ecosystem of entrepreneurship which the study coined ‘*enterpriseneurship*’, which supports existing high-impact entrepreneurs who have already gone some way towards building sustainable enterprises, not only because the chances of success are higher, but mainly because the chances of failure are mitigated. Policies in developed economies should focus on strengthening Entrepreneurial Framework Conditions which are: a country’s ability to induce start-ups and the skills and motivational drivers that compel people to start businesses. The country’s progress towards Entrepreneurial Framework Conditions should happen as levels of economic development rise and more and more of the population becomes involved in “opportunity” entrepreneurship and more people leave “necessity” entrepreneurship (self-employment). Policies in less developed countries should focus on strengthening General National Framework Conditions which are focused at firms, not at individuals - including financial assistance, management assistance, training and the reduction of regulatory burdens.

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